EEI POLICY NOTE

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BAD CREDIT HISTORY

- The Carbon Market's Spring Meltdown and the ETS's Troubled Future*

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* The following Note is limited to a brief history of the ETS collapse and the program itself, focusing instead on the signal this should send to policymakers and the regulated universe why the Second Phase (2008-2012) of the ETS will end the same way this first year of the First Phase ended, explaining the reasons and cautioning against deepening the economic inefficiencies ensured by continuing on this path.

Summary

Observers initially attributed the recent collapse in the European market for carbon credits to lower-than-expected 2004 greenhouse gas emissions, particularly among early-reporting Member States. This, and the market's reaction to such limited information, ignores much, including that the purported over-achievement is not a fair proxy for actual ETS performance, and the ETS is no proxy for Europe's Kyoto-relevant emissions.

Official comment about the ETS's Spring meltdown was largely confined to complaints about Member States independently releasing their data free of Brussels's control. Increasingly, conscious over-allocation by Member States of credits emerged as a factor, as well as the carbon market's immaturity. Other systemic flaws which, although not discussed openly, might explain the uncertainty include European Member States persistently revising emissions data from even fifteen years ago, leaving the market with no reasonable confidence in current or future emission announcements.

Almost unnoticed was the relative absence of green pressure group and bureaucratic self-congratulation over the collapse as proof that the Kyoto Protocol would not be as costly as many predicted. This muted reaction is not surprising if only for the abrupt and significant eradication of wealth. Previously, however, bureaucrats also widely dismissed cost projections with assurances of single-digit credit prices. As such, even those most typically keen to spin saw risk in crowing about a post-collapse price still twice that predicted. Add to this Europe's stealthy transition from serially opposing emissions trading, *ab initio* upon US insistence in Kyoto in 1997, to touting the ETS as Europe's singular creation and success. Further, low prices, whether the predicted 6€ or post-collapse 12€ (later, 9€) – are unlikely to stimulate envisioned emission reductions. Victory may have a thousand fathers; market collapse is an orphan.

The principal unreported story remains that the ETS's long-term viability is predicated upon infusion of a post-2012 supply of carbon credits from large, industrial but "developing" countries presently quite happy outside of Kyoto's reach, *e.g.*, China, India, South Korea, Indonesia and Brazil. Such credits are increasingly unlikely to ever materialize. Already the EU-15, Canada, New Zealand, Japan, and Norway admittedly depend upon buying credits in order to comply merely with their "first" Kyoto promise (2008-2012). Like all countries, their emissions also are rising since Kyoto, not falling, with no transition to real reductions below the 1990 baseline in sight. As such, any post-2012 period carrying promises of real emission reductions, which the numbers make clear are infeasible, demands infusion of other countries, granted targets so high so as to be designed simply to supply credits to Europe, Japan, *et al.*

Therefore the ETS faces more, not less, significant volatility of the kind recently seen barring what would amount to recasting much foreign aid into a scheme for Kyoto's presently covered few to purchase bureaucratically manufactured credits in the name of that treaty. That is, Kyoto can only be saved by killing it, at least as it is known, through a major concession by the EU and their pressure group allies of a Kyoto which is ever more transparently nothing more than a wealth transfer to the rich-but-developing world.

Summary of the ETS

Created by Directive 2003/87/EC,[1] the Emissions Trading Scheme mandates that "from 1 January 2005, no installation undertakes any activity listed in Annex I resulting in emissions specified in relation to that activity unless its operator holds a permit issued by a competent authority".[2] The Directive establishes a pan-European regime under which those states covered with obligations under the Kyoto Protocol[3] must present National Allocation Plans[4] allowing for tradable, verifiable emission credits for carbon dioxide, or carbon dioxide equivalent for other listed GHGs[5] and allocating these credits among installations engaged in covered activities.[6] The objective is to reduce GHGs in a cost-

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[1] DIRECTIVE 2003/87/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 13 October 2003, hereinafter "the Directive", found at http://europa.eu/eur-lex/pri/en/oj/dat/2003/l_275/l_27520031025en00320046.pdf, amended by DIRECTIVE 2004/101/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 October 2004 at http://ec.europa.eu/comm/environment/climat/emission/pdf/dir_2004_101_en.pdf

[2] Id., Article 4. The approach to and indeed complete application of the allocation requirement is left to the Member State. Failure to comply with a State's edict can be costly. See, *e.g*., "Three Spanish companies closed down for violating Kyoto protocol". "The Valencia regional administration yesterday ordered the shutdown of three companies for violating the Kyoto protocol, as they were not authorized to release greenhouse gases. According to government sources, this is the first time in Spain that such measures have been taken. The companies may be fined up to 100,000 euros each, and will need the necessary authorization in order to renew operations. The three companies produce, respectively, paper and cardboard, tiles and bricks, and glass. Regional counselor Rafael Blasco explained that his department is in charge of monitoring the carbon dioxide emissions of over a hundred companies "so that the Valencia region fulfills the goals set in the Kyoto protocol." Those companies included in the first stage of compliance with the protocol must be authorized to emit greenhouse gases, which will allow them to register with the environment ministry for permission to buy and sell emissions rights. According to Blasco, the deadline to apply for emissions permits was September 2004, and since that date factories "have had to obey the criteria set by the law on emissions. The goal of those criteria is to guarantee compliance with the Kyoto protocol and sustainable development in the Valencia region, and therefore companies must inform the regional government on their emissions levels." Spain Herald, 8 September 2005, http://www.spainherald.com/2005-09-08news.html#1416.

Spain's circumstance is slightly unique. "In addition to financial penalties, the installations of Spanish operators who infringe the obligations of the emissions trading law may be totally or partly closed for a period from two to five years respectively depending on whether the infringement is classified as serious or very serious." *Application of the emissions trading directive by EU Member States*, EEA Technical Report No 2/2006, p. 36, http://www.climnet.org/EUenergy/ET/technicalreport_2_2006%5B1%5D.pdf.

[3] Id., *Whereas* para. 25. 23 of the 25 EU countries have a Kyoto obligation, excluding Cyprus and Malta. See, generally, "Greenhouse gas emission trends and projections in Europe 2005" at http://reports.eea.eu.int/eea_report_2005_8/en/GHG2005.pdf.

[4] Id, Article 9. See generally European Commission, Emissions trading – National Allocation Plans, http://europa.eu.int/comm/environment/climat/emission_plans.htm. For environmental NGO perspectives generally see Climate Action Network, *National Allocation Plans* http://www.climnet.org/EUenergy/NAPs.htm. For a March 2006 discussion of ongoing NAP implementation issues, see CEAG summary, particularly slides 20-25, at http://www.ceag.org/EU%20ETS_Session2%2003_06.ppt#1.

[5] Non-CO2 GHGs are calculated for sale on the basis of their based on greenhouse warming potential. Id, Article 3(j). ETS addresses Kyoto's covered GHGs carbon dioxide (CO2), Methane (CH4), Nitrous Oxide (N2O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), sulphur hexafluoride (SF6), Ibid, Annex II.

[6] Covered installations eligible to receive allowances only include those that emit CO2, which means that no allowances are provided to nuclear or renewable installations, and only installations that exist at the time of the national allocation plan being finalised are eligible to

effective manner,[7] although it leaves supplemental emission reduction activities, such as taxation, as an option for Member States.[8]

The ETS is broken into two phases, the three-year period of 2005-2007 serving as somewhat of a "dress rehearsal for the Kyoto scheme",[9] and then the five year Kyoto period 2008-2012.[10] In the first phase Member States allocated their own allowances, or credits to covered facilities, to the larger players among energy, metals and minerals and select pulp and paper sectors.[11] Allocations "shall" be given away without charge at a rate of at least 95% of total first round credits then at least 90% of second round allowances.[12] Emissions may not be presumptively banked for a later period – though again they may be reissued upon their expiration and surrender – but these covered entities then balance their own emissions and projections against their allowances, selling those which they expect to not need.[13]

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receive allowances which excludes planned (or future) installations unless a reserve for new installations is established within the total quantity of allowances. See "Allocation under the EU Emissions Trading Scheme", Olivia Hartridge, European Commission DG Environment, at http://www.rggi.org/docs/hartridge_pres_10_14_04.pdf

As regards how Member States should allocate allowances, the ETS Directive (2003/87/EC), Annex III states in pertinent part, "1. The total quantity of allowances to be allocated for the relevant period shall be consistent with the Member State's obligation to limit its emissions pursuant to Decision 2002/358/EC [NB: Europe's Kyoto "Burden Sharing Agreement"; see discussion, *infra*] and the Kyoto Protocol, taking into account, on the one hand, the proportion of overall emissions that these allowances represent in comparison with emissions from sources not covered by this Directive and, on the other hand, national energy policies, and should be consistent with the national climate change programme. The total quantity of allowances to be allocated shall not be more than is likely to be needed for the strict application of the criteria of this Annex. Prior to 2008, the quantity shall be consistent with a path towards achieving or over-achieving each Member State's target under Decision 2002/358/ EC and the Kyoto Protocol."

7 Id., Article 1.

8 Id., *Whereas* para. 24. Taxation is in fact a far more efficient means of reducing GHGs. See, *e.g.*, "[T]he economic impacts of cap-and-trade programs would be similar to those of a carbon tax: both would raise the cost of using carbon-based fossil fuels, lead to higher energy prices, and impose costs on users and some suppliers of energy." The Congress of the United States, Congressional Budget Office, "An Evaluation of Cap-and-Trade Programs for Reducing U.S. Carbon Emissions", June 2001, p. viii, found at http://www.cbo.gov/ftpdocs/28xx/doc2876/Cap&Trade.pdf.

9 See http://www.ceag.org/EU%20ETS_Session2%2003_06.ppt#3.

10 Id., Article 11.1, 11.2 respectively.

11 An allowance "means an allowance to emit one tonne of carbon dioxide equivalent during a specified period." Id., Article 3(a). For covered gases that may compose a tonne of carbon dioxide equivalent, see Ibid., Annex I, although *Whereas* para. 15 states that "the coverage of the Community scheme may thereby be extended to emissions of greenhouse gases other than carbon dioxide, *inter alia* from aluminium and chemicals activities." Further, Article 30.2(a) calls on the Commission to review the ETS's progress and determine "how and whether Annex I should be amended to include other relevant sectors, *inter alia* the chemicals, aluminium and transport sectors, activities and emissions of other greenhouse gases listed in Annex II, with a view to further improving the economic efficiency of the scheme." STATUS???

SMEs, households, and aviation and other transport were excluded this first time around, which is an important factor to consider when extrapolating from Member State reports into economy-wide projections.

12 Id., Article 10. Most Member States opted to allocate all allowances free of charge. See Hartridge, "Allocation under the EU Emissions Trading Scheme". This however is neither uniform nor permanent.

13 This means that facilities in countries that were at the time of the allocations below their required emissions trajectory to comply with their Kyoto promise would receive allowances,

It is for these reasons that critics assail the free award of these rights to emit, rather to continue emitting, GHGs, as creating a "windfall profit."[14] That is, the companies provided credits find themselves able to continue operations without major disruption while selling the allowances – and many did, for great benefit[15] – thereby reaping financial gain without additional investment or risk. Alternately, one might view allowances as "free" permission slips to continue operating in one's chosen licensed business. The windfall comes if at all solely through regulatory fiat for which it is difficult to blame the regulated entity, even those lobbying for favorable awards.

A factor already proving critical in analyzing the ETS market is the Directive's Article 11.1 provision that each Member State shall decide upon the total quantity of allowances it will allocate for the given period. Even before Europe's May 15 reporting deadline it was clear that overly generous initial Member State allowances contributed to the surprising April emission reports, which oversupply was subsequently confirmed;[16] particularly considering the recently the bid-up credit price, this ensured the collapse.[17]

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which they could then sell to facilities in States above their projected trajectory. As such, this scheme represented an intra-EU wealth transfer from, *e.g.*, Spain, Ireland, Greece and others to (largely) the UK and Germany. For the 2008-20012 period, expect a massive wealth transfer to Poland and the Czech Republic, among others.

Further, parties receiving allowances may choose not merely if to sell them but of course when, as such and as with any commodity the ETS has spawned an active market betting on price volatility.

[14] Power companies – particularly gas and nuclear – have made a profit from the excess number of permits, as the cost of the emissions is factored into the wholesale electricity price regardless of whether or not companies are breaching their emissions levels. See, *e.g.*, "In a recent study, [World Wildlife Fund]…calculated that German utilities were set to make windfall profits of between to €31 and €64 billion until end 2012 due to the free carbon allocations." "Crashing carbon prices puts EU climate policy to the test", Euractiv, referencing report found at http://www.wwf.de/presse/pressearchiv/artikel/02892/index.html.

[15] See also "Power firms see bonanza in emissions windfall", Yorkshire Post, 2 May 2006. ("Power companies in Britain could see their profits boosted by up to £850m under the European Union Emissions Trading Scheme, a consultancy firm said yesterday…The group, which carried out a study of the Emissions Trading Scheme for the Government, said as a result of the higher electricity price, energy firms could see their profits soar by up to £850m between 2008 and 2012 when the next phase of the scheme kicks in.") http://www.yorkshiretoday.co.uk/ViewArticle2.aspx?SectionID=1299&ArticleID=1476362.

[16] See, *e.g.*, "Disparity in carbon permits emerges," Financial Times, 12 May 2006. "British businesses will have to cut their greenhouse gases far more than their continental rivals because of the way the European Union's emissions trading scheme was set up, data on Friday appeared to show. Reports that German companies had received many more permits to produce carbon dioxide than they needed last year sent the price of carbon tumbling. However, data on a European Commission website showed that UK businesses had been issued with far fewer permits than they needed, forcing them to reduce emissions." Found at http://news.ft.com/cms/s/bce2fd8a-e1e7-11da-bf4c-0000779e2340,dwp_uuid=d4f2ab60-c98e-11d7-81c6-0820abe49a01.html.

[17] See, *e.g.*, "It would be premature to trumpet this as good news for there is a strong suspicion that EU governments, of which at least 15 are on track to exceed their eventual Kyoto targets, are being too generous in awarding permits to their industries rather than the latter being unexpectedly successful in cutting pollution.""Carbon Trade on Trial", Editorial, Financial Times, 28 April 2006, http://news.ft.com/cms/s/603874f6-d653-11da-8b3a-0000779e2340.html; see also "Pollution reports hurt CO2 emissions market," Richard Ingham, Agence France Presse, 2 May 2006, http://www.washingtontimes.com/world/20060502-122647-8250r.htm

Also, compare the disinterested assessment that 15 of the EU-23 are on track to *miss* their Kyoto target with a formal EEA claim from December 2005 that "The projections contained

The ETS recognizes qualifying credits from another covered Kyoto country.[18] A scheme allowing these transactions from 8 other EU-25 states was authorized in October 2004.[19] ETS credits expire at the end of the phase for which they were assigned, which does not prohibit "banking" of emission allowances from 2005-2007 for the 2008-2012 period but requires that a Member State demand that allowances be surrendered, which the State may then reissue if this is consistent with their NAP. The ETS sets a per-ton penalty price of 40€ for first-period violations which rises to 100€ during the second round.[20]

The following Commission representation illustrates EU commitments under their Kyoto Burden Sharing Agreement, and their ETS first-period [2005-2007] allowances:

Emissions trading in the EU
Trading period 2005–07
(Indicative data based on the national allocation plans approved by the European Commission)

EU Member State	Allocated CO_2 allowances (million tonnes)	Share in EU allowances (%)	Installations covered (¹)	Kyoto target (%)
Belgium	188.8	2.9	363	− 7.5 (²)
Czech Republic	292.8	4.4	435	− 8
Denmark	100.5	1.5	378	− 21 (²)
Germany	1 497.0	22.8	1 849	− 21 (²)
Estonia	56.85	0.9	43	− 8
Greece	223.2	3.4	141	+ 25
Spain	523.3	8.0	819	+ 15
France	469.5	7.1	1 172	0 (²)
Ireland	67.0	1.0	143	+ 13 (²)
Italy	697.5	10.6	1 240	− 6.5
Cyprus	16.98	0.3	13	—
Latvia	13.7	0.2	95	− 8
Lithuania	36.8	0.6	93	− 8
Luxembourg	10.07	0.2	19	− 28 (²)
Hungary	93.8	1.4	261	− 6
Malta	8.83	0.1	2	—
Netherlands	285.9	4.3	333	− 6 (²)
Austria	99.0	1.5	205	− 13 (²)
Poland	717.3	10.9	1 166	− 6
Portugal	114.5	1.7	239	+ 27 (²)
Slovenia	26.3	0.4	98	− 8
Slovakia	91.5	1.4	209	− 8
Finland	136.5	2.1	535	0 (²)
Sweden	68.7	1.1	499	+ 4 (²)
United Kingdom	736.0	11.2	1 078	− 12.5 (²)
Total	**6 572.4**	**100.0**	**11 428**	

(¹) Please note that the figures do not take account of any opt-ins and opt-outs of installations in accordance with Articles 24 and 27 of the emissions trading directive.
(²) Under the Kyoto Protocol, the EU-15 (until 30 April 2004 the EU had 15 Member States) has to reduce its greenhouse gas emissions by 8 % below 1990 levels during 2008–12. This target is shared among the 15 Member States, marked with (²), under a legally binding burden-sharing agreement (Council Decision 2002/358/EC of 25 April 2002). The 10 Member States that joined the EU on 1 May 2004 have individual targets under the Kyoto Protocol with the exception of Cyprus and Malta, which have no targets.

"EU action against climate change: EU emissions trading - an open scheme promoting global innovation", page 10.

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in the Report on "Demonstrable Progress under the Kyoto Protocol" indicate that 17 of the 23 member states which have emission targets are on track to *meet* them", at http://europa.eu.int/rapid/pressReleasesAction.do?reference =IP/05/1519&format=HTML&aged=0&language=EN&guiLanguage=en.

[18] ETS Directive Article 25.

[19] DIRECTIVE 2004/101/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 October 2004, http://ec.europa.eu/comm/environment/climat/emission/pdf/dir_2004_101_en.pdf. Although agreed among Kyoto's Parties in Montreal at the first Meeting of the Parties, December 2005, a truly international scheme permitting purchase of certified emission reduction units (CER)s or emission reduction units (ERUs) ("credits") from the dozen other covered Kyoto Parties is not yet perfected.

[20] ETS Directive, 2003/87/EC, Article 16.4, 16.3 respectively.

Reports by all EU countries are due May 15, the figures to be collectively released by the Commission annually, beginning 30th June 2005[21] as its first ETS progress report.[22] Already the Commission is expressing displeasure at the non-uniform release of individual Member State data as if they were sovereign nations, dropping hints about imposing at least a temporary secrecy on the data until Brussels can issue pan-European numbers.[23] History suggests such a scenario presents a moral hazard, begging corruption at the EU level with high-stakes riding on figures compiled in the dark, not to mention compounding the pressures at the Member State level by interested parties seeking compiled but unreleased data. A pair of World Bank analysts suggested reporting the data quarterly to aid transparency and reduce the relevant influences contributing to the April collapse, though they indicated no bias toward or against maintaining Member State ability to release their own information.[24]

The Collapse: A Dress Rehearsal?

It is by now exhaustively reported that late in April, following a long and unanticipated climb, the price on the European market for carbon "credits" fell by one half in a single day. Values continued dropping by nearly two-thirds in subsequent trading sessions, ultimately collapsing 75% from their highs with Germany's 12 May emission report.[25] Headlines blared while bureaucrats and investors fretted about the future of this cornerstone of the Kyoto, and particularly Europe's, regime for reducing greenhouse gas (GHG) emissions. Prompting the initial anxiety were reports from France, the Czech Republic, Estonia and Holland that 2004 GHG emissions from covered facilities were not as high as some traders expected, leaving a possible glut of credits.[26]

Spain's exceedance being less than expected was followed by the UK issuing a similar report, neither of which calmed market fears. As is often the case, particularly in nascent operations such as this, such intemperance does not fare well upon sober reflection. The ETS, however, survives scrutiny even less well.

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[21] Id., Article 21.

[22] On this same day in 2006 the Commission shall also submit a report to the European Parliament reflecting the findings of its review for further development of the ETS (Article 30).

[23] "Carbon trading market fluctuates wildly after figures released early", The Guardian, 1 May 2006 http://www.guardian.co.uk/eu/story/0,,1765085,00.html. Such a lack of transparency seemingly runs counter to various transparency provisions of Kyoto, which are admittedly interpreted by the Parties and so offer not much of a threat of unfriendly enforcement, but most certainly the Directive, *Whereas* para. 13.

[24] Report, "State and Trends of the Carbon Market 2006", World Bank and IETA, Washington DC, May 2006, found at http://carbonfinance.org/docs/StateoftheCarbonMarket2006.pdf.

[25] "German C02 emissions below quota, carbon prices dive", Reuters 12 May 2006, http://today.reuters. co.uk/news/newsArticle.aspx?type=scienceNews&storyID=2006-05-12T134455Z_01_L12639992_ RTRIDST_0_SCIENCE-ENERGY-CO2-EUROPE-DC.XML&archived=False. This reflected not just reaction to Germany's report but other reports, as well. "The [Commission] Web site [http://europa.eu.int/comm/environment/ets] showed Britain's emissions came in 31.3 million tonnes above its allocation. Spain was 9.1 million tonnes above quota and Italy was 5.66 million tonnes above target."

[26] The reported shortfalls ranged between 8-15%, with tiny Estonia emitting 25% fewer tonnes than allowances indicated likely. See, *e.g.*, "Crashing carbon prices puts EU climate policy to the test", Euractiv 2 May 2006 http://www.euractiv.com/en/sustainability/crashing-carbon-prices-puts-eu-climate-policy-test/article-154873.

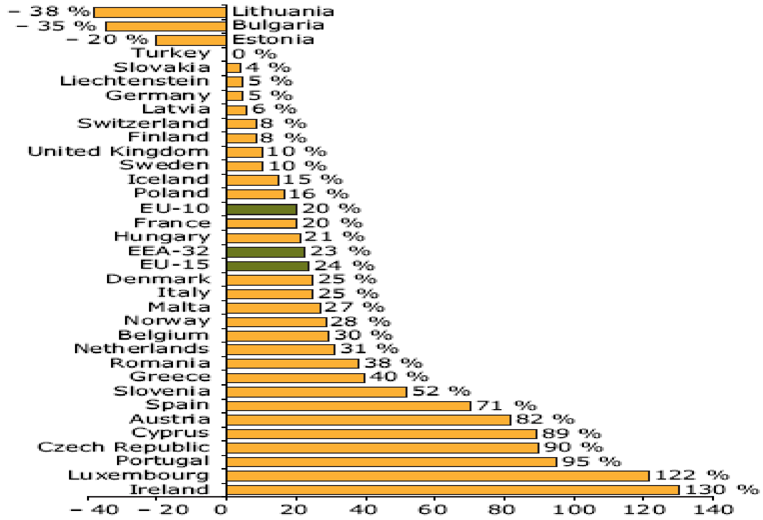
Proxy War?

A slightly bigger-picture view of the market reveals a fairly steep rise in credit prices on the EU exchange over the past year.[27] It had settled into a trading range, from which it broke out just prior to the drop, the spike driven by anecdotal information that Europe was emitting GHGs beyond earlier official predictions.[28] The information prompting the sell-off was expressly incomplete, triggered by reports from Europe's 6th, 7th, 8th and 18th largest emitters. Initial fears of a credit glut were informed as much by performance as by indications that some Member States generously over-awarded their first round of allowances, leaving more credits available than the market reasonably expected.[29]

Yet the young ETS covers only about 40% of Europe's relevant emissions, at about 11,500 facilities.[30] Given that it still excludes key economic sectors, the ETS is a false proxy for economy-wide emission performance. By covering less than half of relevant emissions it excludes *e.g.*, the large and fast-growing transport and household sectors.

Consider the role of these sectors excluded from ETS:

Trends in transport GHG emissions by country (1990–2003):



"Transport and environment: facing a dilemma", EEA Report No 3/2006, page 17. Found at http://reports.eea.europa.eu/eea_report_2006_3/en/term_2005.pdf.

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[27] For a 12-month history of ETS prices see http://www.emissierechten.nl/marktanalyse.htm.

[28] Over the course of 5 weeks stories addressed how "Carbon Prices Struggle To Break Out Of Range" (24th March), followed by several pieces noting record highs for 2006 and 2007 carbon permits, inevitably followed by the price tumble.

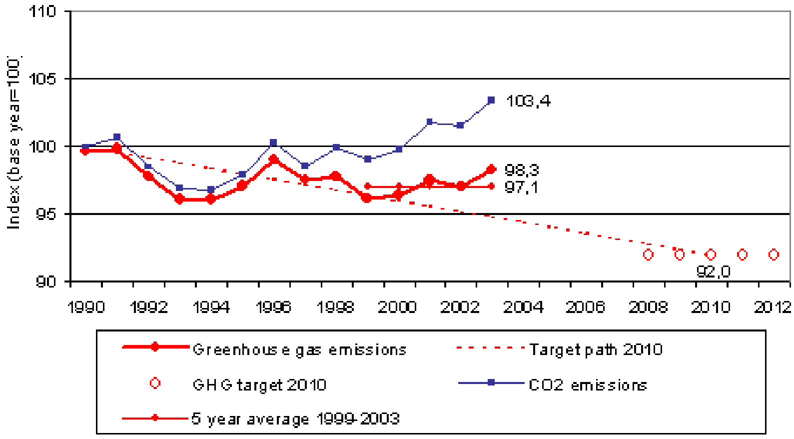
[29] See discussion of ETS Directive Annex III allocation, *infra*. EU Environment Commissioner Dimas all along sought to inspire confidence in the ETS by assuring investors, *inter alia*, "of strict Commission decisions which reduced the number of allowances and prevented an over-supply of emission quotas." SPEECH/06/117, 22/02/2006 http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/117&format=HTML&aged=0&language=EN&guiLanguage=en. It is important to also recall that a State reporting that it came in under its allocation is in no form whatsoever the same as reducing emissions, and in fact these reports offered no demonstration of any Member State actually finding its way on track toward its promise or trajectory.

[30] See, *e.g.*, "This Market Is Sending a Signal", 6 December 2005, http://www.tcsdaily.com/article.aspx?id=120605C. Further, the purported over-achievers are not a fair proxy for EU-wide ETS performance.

In fact, households and services growth over the same period outpaces transport.[31] Finally, these limited reports offered nothing to change Europe's projection of little or no emission reductions from 1990 levels, 2008-2012.

Information Vacuum

The carbon market therefore acted on deeply limited and quite flawed information.[32] Yet these limitations were by no means impenetrable to scrutiny. In truth, it has been readily available to anyone willing to read beyond the press releases that, Europe-wide, CO2 and other GHG emissions remain well above where promised.[33] Further, rather than being on a downward trajectory toward complying with Kyoto, EU emissions are rising across the Member States and economic sectors. For example, see Europe's own "hockey stick":



Source: European Environment Agency, 21 June 2005,
http://org.eea.eu.int/documents/newsreleases/ghg_inventory_report-en

Systemic Problems

That the market jitters represent an overreaction could well be borne out by a rebound in credit prices, although it must be said that Member State distortion of data and allocations[34] could legitimately continue to drag on market

[31] See EEEA News Release, "Increased power production drives EU greenhouse gas emissions up in 2003, Copenhagen, 21 June 2005 http://org.eea.eu.int/documents/newsreleases/ghg_inventory_report-en.

[32] See generally "Volatile Gases", Iain Murray 11 May 2006 http://www.tcsdaily.com/article.aspx?id=051106A. It is noteworthy that EU Environment Commissioner Stavros Dimas dismissed market jitters as resulting from "speculation," ignoring that speculation is the sole premise for the market other than artificially created scarcity. "EU will learn from emissions trading mistakes – Dimas", 9-May-2006, http://www.edie.net/news/news_story.asp?id=11427.

[33] See, *e.g.*, "Increased power production drives EU greenhouse gas emissions up in 2003", European Environment Agency, 21 June 2005 http://org.eea.eu.int/documents/newsreleases/ghg_inventory_report-en

[34] See, *e.g.*, "Brussels fails to halt slide in carbon dioxide permit prices", Financial Times, 3 May 2006 http://news.ft.com/cms/s/18cad022-da41-11da-b7de-0000779e2340.html. The author has been told by one well-placed source of suspicions that, manifesting tensions between national capitols and Brussels, Member States actually over allocated quite consciously and in hope of assisting ETS failure.

performance.[35] Other systemic problems exist, however, and should rationally prompt any future price spike to be followed by yet another collapse upon realization that ETS success is premised not upon EU emission reductions but, equally futile, on growing global participation to supply credits from non-EU countries.

The latter point is the immediate lesson, and it is largely being missed amid initial coverage of the price collapse focused on the possibility that covered facilities were reducing emissions faster and better than predicted, which soon gave way to claims that the market was simply fatally flawed, if for myriad postulated reasons.

European Omission

Economists rushed to the debate to warn that low credit prices would not be sufficient to force sustained emission reductions. This otherwise facially legitimate concern elides key, relevant considerations that the ETS was created amid promises of prices a fraction even of their post-collapse price (see discussion, *infra*), and that market function requires not merely that information be available but and transparent, but accurate. The problem with the information triggering the April-May meltdown was not, as Brussels leapt to claim, that it was issued piecemeal. The problem was information of questionable legitimacy, its meaning further skewed by, *e.g.,* manipulating allocations. [36]

What did not occur was a rush of bureaucrats or pressure groups to claim vindication in the price drop, having previously assailed those who questioned their claims of single-digit carbon prices while also assuring that the scheme would serve as the economic impetus for sufficient emission reductions.

Further hamstringing their ability to seize the turmoil for rhetorical gain is that even after an initial collapse of two-thirds the prices remained 200% of what many governments and ministries had promised in order to gain political buy-in, also describing higher estimates as scaremongering. For example, in October 2004 Spain's Cristina Narbona took to the airwaves to angrily deride a PriceWaterhouseCoopers projection[37] of prices in the 15-20 € range as "false" –

[35] See, *e.g.*, Murray, "A price is essentially information. At its simplest, the price paid for a permit represents merely the cost of undertaking the activity for which the permit is granted. Permits have been auctioned in the past at least partly to establish the true level of such costs. However, when permits are traded, extra information is added that changes the price from a mere reflection of the cost. Scarcity value is the most obvious example: when the market believes permits will be scarce, their value increases. If there will be enough for everyone who wants one to get one, no scarcity value will be added. Thus a rise or drop in price will reflect the market's greater emerging knowledge about the actual level of scarcity involved.
Prices can rise or drop quicker when speculation is involved and traders are essentially gambling that scarcity will be greater or less than the market as a whole believes. Wide price fluctuations, therefore, inevitably represent a lack of complete information about the nature of the market. Political uncertainty or lack of transparency related to the market merely lessens information available and therefore contributes to market uncertainty (this should be borne in mind when considering demands to keep emissions information secret)." Found at http://www.tcsdaily.com/article.aspx?id=051106A.

[36] See discussion, *infra*. See also, "Carbon Market Grows 10 Fold, Needs Openness – World Bank , Reuters, 11 May 2006 "'We need more emphasis on verification to prevent a systematic inflation with overgenerous allocations,' Peter Kreuzberg of utility RWE's trading unit RWE Trading said at the World Bank news conference." Found at http://www.planetark.com/dailynewsstory.cfm/newsid/36301/story.htm.

[37] See www.pwc.com/es/esp/ins-sol/survey-rep/kioto.pdf.

while also asserting that such prices would indeed be cause for panic – insisting instead that 5-6 € was the reasonably anticipated price.

Although it would be highly disingenuous, this is after all the Kyoto debate so one might nonetheless expect Kyotophile politicians to crow about the drop in credit prices. Yet there were in fact precious few such braggarts willing to also risk calling attention to their prior prognostications.

Still, the larger systemic problems continue to escape most analysis. These generally relate to the reality that the refusal by the rest of the world to join the promises of emission cuts embraced by Europe and a dozen other states ensures insufficient credits to satisfy any deeper, post-2012 promises. As contemplated, these involves real reductions from the 1990 baseline, not merely the opportunity to shuffle burdens due to a convenient baseline year, as was the case for Europe in Kyoto.

In fact, notwithstanding hyperbole about unexpected emission cuts driving the market down, it appears that only cynical administrative tricks such as fudging the 1990 baseline figures – which by mitigate Member States' Kyoto violations mitigates the demand for credits and eases an erstwhile shortfall – will avert the ETS and Kyoto from being a bust 2008-2012. With no credits available to make up for Europe's lack of real emission reductions post-2012, it is difficult to see how Europe escapes the corner into which it painted itself and the major political defeat it has gone to extraordinary lengths to forestall, without betraying the literally billions spent on GHG credits as a failed and costly experiment of unprecedented proportions.

True State of Play

Critically, the EU remains far from where it promised it would be by this point in time, and from where it needs to be should it harbor any hopes of meeting its collective, "bubble" commitment under Kyoto through emission reductions.[38] In

[38] According to recent submissions by the EU-25 it appears that the EU-15 projects falling short of its collective "bubble" promise by around 309 million metric tonnes (For a quasi-official listing of the worst offenders see http://www.ceag.org/EU%20ETS_Session2%2003_06.ppt#29; for figures see discussion, *infra*). Factoring in credits projected from the EU-10, which credits if sufficiently available are permissible for the EU-15 to meet their "bubble", leaves the EU-25 still approximately 115-120 million metric tonnes short of their promise (or about 2 ¼% of their starting baseline emissions, as presently claimed). This is according to available projections which include "with measures" enacted, as well as hypothesized credits that might be realized using Kyoto's Joint Implementation and Clean Development Mechanism (see, generally, http://unfccc.int/kyoto_mechanisms/items/1673.php). The anticipated international trading regime has yet to emerge, although if and when it does there will be greater competition for scarce credits, *e.g*., from Japan, Canada and New Zealand. Russia remains the largest potential, non-EU source for credits, with likely about 600 million metric tonnes (Romania and Bulgaria anticipate somewhere above 100 million metric tonnes to sell, while non-EU Kyoto non-performers will likely need around 450 million metric tonnes). However, Russia persists in its failure to adopt domestic reforms necessary to sell their GHG credits and barring a desperate lowering of relevant standards this does not appear soon to change.

This appears quite problematic for Europe. It may not be insurmountable, if for very unsavory reasons. It is, for example, critical to note that as of 2006, EU figures for Member State 1990 emission baselines continue to be revised, generally upward, such upward revision which also mitigates the extent of projected violations. Given that this impacts demand for carbon credits this annual, a generally self-serving revision of 10- then 15-year-old figures fact, despite press releases plainly claiming otherwise,[39] the actual reports issued by Europe reveal its dependence upon an influx of credits from the EU-10 in order to have any hope of complying with the political totem which Kyoto has become.[40]

Data imply that between now and when Kyoto is in full swing, carbon credit prices should in fact spike for the same reasons they initially rose, and particularly given the 40 euro per ton penalty the EU imposed on itself through its Directive. Upon further consideration, however, traders should also realize that one implication of the simple political impossibility of there ever being a Kyoto Round II is that the ETS will become similarly paralyzed in the face of uncertainty over its future tracking perfectly with Kyoto's own inability to bring on new covered Parties.

Remember that Kyoto is by its own terms not in reality binding, let alone "enforceable" as touted.[41] Member States are however subject to jurisdiction of the European Court of Justice, to which the Commission has already referred violators of various environmental regimes.[42] As such the pressure facing Europe should add urgency to the already considerable pressure borne of expending substantial political capital on Kyoto and ETS. This should actually drive Kyoto's own urgency to find a face-saving way out for its leading Parties which, as discussed, *infra*, will require some preferential wealth-transfer scheme to create a stream of carbon credits. An alternate scenario that might change this is Europe ultimately deciding to treat its "binding" ETS as it did the Stability and

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also impacts the credit market, both present and future. With its deeds Europe therefore assures observers that emission figures cannot be judged with confidence even after 15 years. As such it is certainly fair to ask how, and why, observers including the credit market should have any confidence in their words when reporting figures for emission performance 2005-2007 and, more importantly (because larger penalties kick in as well as putative Kyoto sanctions), 2008-2012.

[39] See *e.g.*, EEA Press Release, 12/05, announcing annual numbers, "Climate change: EU on track to reach Kyoto targets, latest projections show." "The EU is well on its way to achieve its Kyoto Protocol targets for reducing emissions of greenhouse gases on the basis of the policies, measures and third-country projects already implemented or planned...The latest projections from member states indicate combined EU-15 emissions [reducing] to 9.3% below 1990 levels by 2010. This clearly fulfils the 8% reduction target from 1990 levels that the protocol requires the EU-15 to achieve during 2008-2012." http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/05/1519&format=HTML&aged=0&language=EN&guiLanguage=en

[40] The first paragraph of the first page of the first section of the contemporaneous EEA document, "Greenhouse gas emission trends and projections in Europe 2005", admits instead that "*Even with* planned *additional* domestic policies and *measures*, *the target will not be reached*." (emphases added) http://reports.eea.eu.int/eea_report_2005_8/en/GHG2005.pdf.

[41] See "An Assessment of Montreal COP/MOP1: Implications for the Kyoto Protocol "Post-2012" of the "First Meeting of the Parties" Weakening Kyoto's Emission Reduction Promises and Prospects for Enforceability," Christopher C. Horner, January 2006 http://ff.org/centers/csspp/pdf/20060126_horner.pdf.

[42] See, *e.g.*, "EU climate change policies: Commission asks member states to fulfil their obligations", Reference: IP/06/469, 06/04/2006, http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/469&format=HTML&aged=0&language=EN&guiLanguage=en.

Growth Pact,[43] regularly flouted by its Member States but to date without the threatened penalties attaching.[44]

Until new numbers are released this summer, at present the EU-15 emissions stand as follow.[45]

<u>Projected GHG Emissions, Kyoto Performance: EU, Canada, US</u>

Country	MMt 1990	Kyoto	2010 est. Mt	2010* (Cf 1990)	2010 (Cf CP1)
EU-15:	*(<u>Irrelevant</u> as there is no "EU-15" bubble for Kyoto 2d CP purposes after violating 1st CP)*				
PT:	59.4	75.4	90.5	+52.4%	+20%
ES:	286.8	329.8	437.5	+52.5%	+32.7%
Canada	607	570.6	686	+13%	+20.2%
GR:	111.7	139.6	150.4	+34.6%	+7.7%
USA	*6038*	*5615*	*8115*	*+34%*	*+45%*
IR:	53.4	60.3	71.3	+33.5%	+18.2%
LU:	12.7	9.14	15.3	+20.5%	+67.4%
FN:	70.5	70.5	79.7	+13%	+13%
DK:	69.6	55	72.5	+4.2%	+31.8%
FR:	545	545	594.3	+9%	+9%
AT:	77.6	67.5	84.4	+8.8%	+25%
BE:	144	133.2	148.4	+3.1%	+11.4%
IT:	508.9	475.9	580.4	+14%	+22%
SW:	72.2	75	71.5	(99%)	(95.3%)

[43] See *The Stability and Growth Pact* http://ec.europa.eu/economy_finance/about/activities/sgp/sgp_en.htm.

[44] See, *e.g.*, "EU Needs Fiscal Watchdog to Replace Stability and Growth Pact", Centre for Economic Policy Research, 4 December 2003 (http://www.cepr.org/press/mei13.htm) for discussion.

[45] Regardless of their official status some projections are also officially acknowledged as being far from realistic given current emissions. Consider Canada, whose Prime Minister in May 2006 declared that "emissions are 35% above the Kyoto target". Press Release, "Ambrose Wants Realistic, Results-Oriented Approach to Climate Change", 11 May 2006, at http://www.ec.gc.ca/press/2006/060511_n_e.htm. Note also the looming controversy over the Member State practice of cheating their all-important 1990 baseline figures, typically upward, which accounting gag 15 years after the fact of course lowers a potential Kyoto violation. See Horner, "The Gambler's Dilemma" at 15-16.

NL:	212.9	200.13	215.8	+1.4%	+7.8%
DE:	1,248.3	986.2	1000.9	(80.2%)	+1.5%
UK	753.9	659.7	597.3	(79.2%)	(90.5%)

* -- As a % of 1st CP# (Cf. BSA promises for EU-15 and .93 and .94 for US and Canada, respectively)
For individual EU member country figures, http://reports.eea.eu.int/technical_report_2004_7/en/annex1_tech7-2004_ID879.pdf and http://reports.eea.europa.eu/eea_report_2005_8/en/tab_content_RLR.

Consequence: ETS = Extremely Tenuous Situation

The unreported story remains that Europe is preparing to make promises of deeper cuts,[46] although it stands no chance of actually making them and therefore would completely rely upon infusion of a supply of carbon credits from large, industrial but "developing" countries presently, and happily, outside of Kyoto's reach, *e.g.*, China, India, South Korea, Indonesia and Brazil. Consequently, the ETS's post-2012 viability is predicated upon such credits, which are increasingly unlikely to ever materialize. Already the EU-15, Canada, New Zealand, Japan, and Norway expressly depend upon buying credits in order to comply merely with their "first" Kyoto promise (2008-2012). Their emissions also are rising since Kyoto (1997), not falling, with no transition to real reductions from the 1990 baseline in sight. The same holds true for those countries presently pegged by the EU-15 to supply credits for compliance with "Kyoto I", the former Soviet Bloc.[47] The numbers therefore leave no mistake that ETS – and indeed, Kyoto – survival post-2012 requires numerous, large additional countries implausibly signing on to Kyoto's "binding, enforceable" emission reductions.

From Russia with Love[48]

Kyoto's few covered Parties must ultimately lure new entrants on board to ensure a supply of credits, likely through some form of the Russian proposal tabled at the "MOP-1" in Montreal. This involves setting "voluntary" emission caps well above current levels and carrying no penalties in the case of exceedance.[49] Most green pressure groups with whom Europe teams to advance

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[46] EU leaders have endorsed plans to bring carbon emissions of greenhouse gases to 15 to 30 percent below 1990 levels by 2020. See *e.g.*, Council of the European Union, Press Release, Brussels, 10 March 2005 found at http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressdata/en/envir/84322.pdf, p. 13.

[47] The UNFCCC acknowledges that the EU-10's emission reductions from 1990-2000 came through economic downturn which, like the emission reductions, has reversed. "The bulk of the reductions in the GHG emissions from Annex I Parties was due to the steep economic decline in the countries of eastern Europe and the former USSR, resulting from the transition from centrally planned to market economies and associated structural changes. In recent years most of these countries have experienced appreciable economic growth which is projected to lead to increased emissions in the future." *UNFCCC Third Communications' Synthesis*, http://unfccc.int/resource/docs/2003/sbi/07.pdf.

[48] The following discussion was first presented in Horner, "An Assessment of Montreal COP/MOP1", http://ff.org/centers/csspp/pdf/20060126_horner.pdf at p. 6.

[49] A version of this has already been done if for a different purpose when Europe invoked Kyoto Article 4 to assign an emission "reduction", or cap, to Spain, Greece, Portugal, and others *above* 1990 emissions, and allow France and others to make no reduction (*Cf.* 1990), instead of the 8% below 1990 figure that each EU-15 country originally signed and ratified. These, in effect, exemptions from their promised Kyoto cuts were intended to be offset by deeper cuts by the UK and Germany than their original promise which were unrelated to, and

the Kyoto agenda, and block alternatives, are not presently disposed to accept such a rescue plan. Pragmatism, and pride, may change this.

The European Union has inarguably staked tremendous political capital, indeed the most of any political entity be it a country or the United Nations, on claiming the treaty a success.[50] It is such that triumphant proclamations loudly emanate in the face of obvious failure to actually reduce emissions as planned. In fact, so long as the Bush Administration remains in office (through the December 2008 COP-14/4th Meeting of the Parties) Kyoto likely will remain a totemic symbol of European resistance to the United States, out of the revisionism that somehow the Bush Administration originated rather than merely remained true to existing Clinton Administration refusal to seek Kyoto ratification.[51] Despite looming Kyoto violations[52] by most of those actually covered by the treaty's rationing, there is an increasingly apparent commitment by the Kyoto establishment to ensure no obstacle remains to asserting Kyoto's triumph.

Consistent with recent experience and such expectations, talks to develop a "post-2012" Kyoto regime, begin this month in Bonn[53] and seem destined to culminate in some agreement under which the exempt majority continue to refuse joining the covered few. The question has long seemed whether the latter will maintain and possibly even deepen their promised emission cuts. While no longer certain given Canada's recent actions (see *infra*), such an outcome would doom the ETS and any iteration of Kyoto post-2012. With Russia to date still having failed to institute the domestic reforms necessary to allow their carbon credits to be verified and made available on the open market it, too, needs to find some way to salvage the current process from collapse, or risk foregoing fairly massive rents anticipated under Kyoto.[54]

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in fact preceded Kyoto. Australia, which has not ratified Kyoto, was also allowed an increase over 1990. The increases allowed to lure China *et al* to sign on would of course be far greater.

[50] See generally, Horner, "The Gambler's Dilemma: Europe and Kyoto, A post-Gleneagles, post-Laos assessment of the truth -- and consequences -- surrounding the EU and Kyoto post-2012." European Enterprise Institute, October 2005 http://www.european-enterprise.org/public/docs/policy_paper.pdf

[50] See discussion of Europe's projections at http://www.999today.com/environment/news/story/2529.html, Japan's numbers at http://unfccc.int/resource/docs/natc/cannce3.pdf, and Canada's performance at http://pqasb.pqarchiver.com/thestar/751559401.html?did=751559401&FMT=ABS&FMTS=FT&date=Dec+3,+2004&author=&pub=Daily+Mercury&desc=Missing+mark+on+Kyoto.

[51] See discussion in Horner, "The Perils Of 'Soft' And Unratified Treaty Commitments", 2 December 2003, http://www.cei.org/gencon/025,03297.cfm.

[52] See discussion of Europe's projections at http://www.999today.com/environment/news/story/2529.html, Japan's numbers at http://unfccc.int/resource/docs/natc/cannce3.pdf, and Canada's performance at http://pqasb.pqarchiver.com/thestar/751559401.html?did=751559401&FMT=ABS&FMTS=FT&date=Dec+3,+2004&author=&pub=Daily+Mercury&desc=Missing+mark+on+Kyoto.

[53] See http://unfccc.int/meetings/sb24/items/3648.php. These talks initiating now are pursuant to Kyoto, Article 9, paragraph 1 reading "The Conference of the Parties serving as the meeting of the Parties to this Protocol shall periodically review this Protocol in the light of the best available scientific information and assessments on climate change and its impacts, as well as relevant technical, social and economic information. Such reviews shall be coordinated with pertinent reviews under the Convention, in particular those required by Article 4, paragraph 2(d), and Article 7, paragraph 2(a), of the Convention. Based on these reviews, the Conference of the Parties serving as the meeting of the Parties to this Protocol shall take appropriate action."

[54] Although these rents may not be quite so large as originally anticipated. For discussion generally, see Illarionov, http://www.iccfglobal.org/ppt/Illarionov-013004.html.PPT#1.

As such, Russia actually expended great energy seeking to initiate a means for penalties to be eschewed for newcomers in practice if not press release, and develop a scheme by which the exempt majority accepts something akin to a voluntary "shall not exceed" emission number enabling them to sell GHG "credits". This would allow for a direct wealth transfer in lieu of Kyoto's unpredictable other mechanisms already deeply hobbled by bureaucracy.

The proposal met with great resistance. As documented contemporaneously by the Pew Center on Global Climate Change, "The final negotiations on the decision went through the night as Russia…continued to argue in plenary for a procedure allowing non-Annex I countries to take 'voluntary commitments.' As a compromise, Russia accepted text in the COP/MOP conclusions referencing its proposal and inviting the President to undertake consultations and report back at COP/MOP 2."[55]

Canada, while chair of the UNFCCC, has now broached the subject of shifting to voluntary targets for otherwise covered, Annex I Parties.[56] Painful though the reality may be to the Kyoto establishment that such a step-down is imperative, the European Commission seems to at some level recognize it. Consider its 2005 statement to other EU institutions titled "Winning the Battle against Global Climate Change".[57] Noting that very soon most GHG emissions will come from other than those parties covered by Kyoto obligations, the Commission opens its discussion of next steps with an undeniably sympathetic priority, that "[t]he importance of broadening international participation in efforts to tackle climate change *cannot be overestimated*" (p.4)(emphasis added).

Here is how IISD reported the relevant discussions in Montreal touching upon the sensitive topic of new parties joining Kyoto's foundering "mandatory" scheme:

> "Japan's proposal recognized that the Protocol is only a first step. Noting that emissions in non-Annex I countries are growing rapidly, it proposed initiating further consideration of Annex I commitments and preparing a review under Article 9, and recommended that COP 12 starts a review of the UNFCCC to construct an effective framework in which all parties participate to take action."[58]

How does the exempt majority (as represented by the "G-77 plus China") feel about that? As always, that global warming is such a great threat that rationing is a great idea, so long as it only means for other people:

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[55] "COP 11 and COP/MOP 1 Montreal" http://www.pewclimate.org/what_s_being_done/in_the_world/cop11/index.cfm.

[56] See, *e.g.*, "Ottawa wants Kyoto softened", Toronto Globe and Mail, 12 May 2006, http://www.theglobe andmail.com/servlet/story/LAC.20060512.AMBROSE12/TPStory/?query=Kyoto+softened.

[57] "Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and Committee of the Regions", COM (2005) 35 final, 9 February 2005, found at http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2005/com2005_0035en01.pdf.

[58] http://www.iisd.ca/vol12/enb12291e.html. IISD continued, "While there was no separate text issued on Protocol Article 9, parties agreed to President Dion's proposal to include in the report of the meeting an invitation for parties to submit relevant information and views on how best to proceed under Article 9, by September 2006." Ibid.

> "Reaffirming that no new commitments shall be introduced under the Protocol for non-Annex I Parties, the G-77/China proposal called for an open-ended *ad hoc* group to consider further commitments from Annex I countries with a view to adopting a result at COP/MOP 4."[59]

Given this, and that other proposals will doubtless emerge, heretically deviating from the original Kyoto scheme but proffered in the name of pragmatically rescuing Kyoto from a death inflicted by adhering to its own formula, the focus will remain on ways to claim that the exempt emitters have joined Kyoto in some meaningful capacity. That scenario in sum is a "give" by the exempt majority for the "get" of rents gained from selling carbon credits post-2012 derived from falling below a far-off, future cap established precisely for the purpose of such sales. Again, as this will result in no global reductions but only political claims of victory. Most of the Green establishment will at first be very noisy in opposition. The crucial parties to how this plays out are the pragmatic policymakers, NGOs, and the rent-seeking businesses who give the agenda its cover.[60] Ultimately, all will realize that if the game dies after 2012, they killed the golden goose, which prospect will doubtless clarify their collective thinking.

Along the road to the final decision on such a radical departure from Kyoto dogmatism, splits will develop among the pressure groups and rent-seeking industry, and within the NGO community itself. The stakes will truly be the continued existence of the idealized Kyoto, however deeply flawed it is and will be made further. As such, to the Greens, such a debate will offer nothing short of an existential crisis, a declaration of war on Kyoto's rationing agenda and in the name of Kyoto. This will test the movement's pragmatism, as surviving "purist" elements confront those interests driven by the desire to ensure a profitable cottage industry verifying reductions, credits and trades and otherwise a well-funded role in the process. Given this, one might expect the Kyoto industry to coalesce on some perpetuating deal, although to what end remains uncertain given that each such accommodation to date has merely dug Kyoto's ditch deeper.

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[59] Id.

[60] See, *e.g.*, "Labor's left-wing powerbroker Martin Ferguson has urged the party to renounce the Greens and support the Howard Government's Asia-Pacific climate partnership. Mr Ferguson, who also reiterated his support for nuclear power, opened a split in the party and the Left after acting Labor leader Jenny Macklin yesterday criticised the six-nation Asia- Pacific Partnership on Clean Development and Climate talks in Sydney." The Australian, 13 January 2006. See also Ferguson, "It's time to abandon the political correctness espoused by the green movement. Let's be real: without getting business on board we cannot achieve anything." Ibid.

Conclusion

The above dictates that the ETS will face more significant volatility of the sort recently seen, not less, barring what is in essence a redefinition of much foreign aid into a scheme for Europe, *et al.*, to purchase bureaucratically manufactured credits in the name of Kyoto. This will develop as realization spreads of the failure of the ETS's underlying assumptions. In the near term, legitimate fears over Member State emission data and allocations will give way to prices recovering somewhat amid more accurate extrapolation of emissions data to EU- and economy-wide performance.

The certain rise in prices from mid-May levels could even see return of a price spike, when the market understands that the international credit market is rather more tight than assumed during the Spring meltdown. This price recovery will presage only another collapse, amid desperate political calls for calm and for some face-saving way out of the Kyoto stalemate. This can only be avoided by a major concession by the EU and their pressure group allies to accept a Kyoto that is ever more transparently no more than a wealth transfer to the rich-but-developing world.