

The case for plurilateral environmental markets

'Economic history is the story of the gradual extension of the economic community beyond its original limits of the single household to embrace the nation and then the world'

Ludwig Von Mises, *The Theory of Money and Credit*



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Diplomats return to the negotiating table this fall in Marrakech to work out further details of the Kyoto Protocol amid a flurry of activity surrounding emissions trading. Individual trades continue to be closed since the last meetings in Bonn. At the same time, individual governments are beginning to take action.

Seeking to become the world leader in emissions trading, the UK announced that it will launch the first comprehensive market in April 2002. The announcement is significant for several reasons: it represents the first governmental push since the historic agreement in Bonn; it illustrates one particular sovereign approach to domestic goals; and it provides insights into how an international market may evolve.

The motivation was unambiguous. Michael Meacher, the UK Minister of the Environment, indicated that the government's purpose was to give British business a lead in this area – a laudable goal. The UK had previously announced its goal of reducing greenhouse gas (GHG) emissions by 23% below their 1990 level by 2010.

Several important points should be noted by students of environmental markets. The programme was developed by the government and a consortium of businesses known as the Emissions Trading Group. It is a voluntary programme. Participating companies agree to take on an emissions cap in exchange for government-funded incentives and their right to sell surplus credits. A government budget of £215 million (\$310 million) has been established by the public sector to provide incentives for companies to join. Implementation will begin with a competitive bidding process in the first quarter of 2002 that will establish both the targets and incentives.

Separately, the British government has indicated that it will attempt to merge this domestic scheme into the pilot European

Union programme scheduled to begin in 2005 with as little friction as possible. The EU programme will ultimately be part of the world-wide scheme envisioned in the Kyoto Protocol.

Other individual sovereign efforts are also under way. In the Netherlands, the government plans to set up a CO₂ trading system by 2004–05. In Japan, a working group comprising members of both the public and private sectors has been meeting for the past few months to discuss setting up an emissions trading market. Denmark launched the first domestic market but it was limited solely to the power sector. The Danish programme includes only eight companies and no trades were recorded by the Danish Energy Agency (DEA) in 2000. Several participants in the Danish scheme have expressed an interest in setting up an exchange, according to the DEA.

In the US, legislation aimed at addressing climate change through the use of market mechanisms continues to appear both at the federal and state levels. Recently, Senators McCain (R – Arizona) and Lieberman (D – Connecticut) have publicly endorsed the establishment of a domestic cap-and-trade programme for the US, later to be expanded to the rest of North America. In the US private sector, the Chicago Climate Exchange has just started its design phase, and now includes a total of 35 entities that will help design a market to be expanded to the rest of the North American Free Trade Agreement (NAFTA). All these efforts will start to be harmonised in the next few years. They are summarised in the table below.

We have long both advocated and forecast that the development of an international GHG market would emerge from a 'bottom up' and voluntary approach. This mirrors the

history of other internationally traded markets. Furthermore, the evolutionary process of market development is also consistent with the history of international political co-operation. International agreements tend to grow from small beginnings – the European Coal and Steel Community has evolved into the Common Market and, now, the European Monetary Union.

In the case of carbon trading, the UK has taken the first comprehensive step and we believe that a group of countries will coalesce into what we have called a 'plurilateral'* trading regime. This will require mature individual markets as well as harmonisation among them. It is very important to emphasise that the historical record indicates that integration of markets can succeed even if the individual markets exhibit fundamentally different characteristics. The development of efficient markets will probably occupy market participants for the next five to 10 years. Sometime during this first decade of the 21st century we hope to see a truly international GHG market that is as efficient as those of other internationally traded commodities.

Finally, as promised, an update on the Chicago Climate Exchange (CCX). The Joyce Foundation in August awarded funding for the design phase of the CCX. Both the foundation and the Kellogg Graduate School of Management at Northwestern University remain committed to the idea. Westcoast Energy, a Canadian energy group, and Michigan-based CMS Generation have joined the design phase and three more individuals have agreed to join the CCX advisory board. They are Mary Schapiro, head of the regulatory arm of NASDAQ; Elizabeth Dowdeswell, a former executive director of the United Nations Environment Programme; and Dr R K Pachauri, the head of Delhi-based Tata Energy Research Institute (TERI). We extend to them our warmest welcome. **EF**

* A 'plurilateral' regime refers to the development of a framework for GHG emissions trading involving a medium-sized set of countries (eg, five to 20). The concept of a plurilateral regime was first introduced by Environmental Financial Products at the first UNCTAD GHG Emissions Trading Policy Forum in Chicago in June 1997 and at the second Policy Forum in Toronto in November 1997. I would like to thank James Perkaus for first introducing this concept into the discussions while acting as a consultant to Environmental Financial Products in 1997

Recent sovereign and private initiatives

Country/region	Initiative
UK	Domestic market to be launched in spring of 2002
Denmark	Cap-and-trade system for power sector; some companies plan to set up an exchange
Netherlands	Cap-and-trade system by 2004–05
European Union	EU-wide emissions trading system by 2005
United States	Chicago Climate Exchange; federal and state level legislative initiatives
Japan	Private-public sector working group on emissions trading