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A Carbon Trading System Worth Saving

By **THE EDITORIAL BOARD**

The European Union became a pioneer in tackling climate change by starting the first major cap-and-trade system designed to reduce carbon-dioxide emissions by putting a price on them. But analysts are **increasingly worried** that technical mistakes, Europe's prolonged recession and the failure of policy makers to strengthen the system is undermining its effectiveness.

Like all such systems, Europe's program caps the overall emissions that power plants, steel mills and other industries can put into atmosphere. The cap, which is regulated through permits, declines every year, forcing businesses to become more efficient or buy permits from another firm or on the open market.

Recently, the price of permits has **collapsed** to less than 4 euros (around \$5.25) per ton of carbon, down from nearly 30 euros in 2008. This is troubling because the low price discourages emitters investing in climate-friendly technologies and fuels. In Britain, for instance, electric utilities have cut back on cleaner-burning natural gas and are using more coal, which puts roughly twice as much carbon into the atmosphere.

There are several reasons for the sharp drop in carbon prices. European governments issued too many permits in the first place because they miscalculated how many would be needed to achieve their goals. And the recession, high unemployment and weak demand for electricity have cut industrial emissions to the point where companies simply do not have to buy allowances to meet their caps. European policy makers haven't helped either. Earlier this month, the European Parliament considered temporarily tightening the overall cap to boost the price of allowances. But opposition by several countries that rely heavily on coal torpedoed the measure.

What is most worrying about the drop in the price of carbon is that it could discourage policy makers elsewhere in the world, including Washington, from addressing climate change if they conclude that Europe's experience is a bust. Several national and state governments have started or are pursuing similar approaches.

But the news from Europe is not all bad. Emissions have fallen by 14 percent among sectors covered by the program in countries that have participated since 2005. Analysts attribute much of that reduction to the cap on emissions, not the recession. The system could work even better if Europe's leaders find the ingenuity to strengthen it and the political courage to weather the criticism that could result from higher electricity prices.

In addition to its trading scheme, Europe has made real progress in dealing with climate change through policies encouraging energy efficiency and renewable sources of power like wind and solar. But nothing would do more to drive down emissions than putting a meaningful price on them, either through a carbon tax or through a cap-and-trade system. Europe's job is to put that system on a sounder footing to make sure it doesn't undo the real progress it has made.

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