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MARKET PLACE

Data Leaks Shake Up Carbon Trade

By HEATHER TIMMONS

Correction Appended

LONDON, May 15 — It had a promising start, hailed by traders, policy makers and environmentalists as a way to curb global warming with the craft of capitalism. After a banner first year, though, the carbon trading market has suffered a bout of nose dives, missteps and misreadings, leading now to a clamor for major change.

It may be just growing pains. But it could point to big problems ahead in carrying out the dictates of the Kyoto Protocol, which many countries are counting on to manage climate change.

Volume hit $10 billion in 2005, and may grow to as much as $30 billion this year, according to World Bank estimates. By comparison, the value of the entire wheat crop of the United States in 2005 was $7.1 billion.

"The market is nervous and needs to see moves to a more reliable structure to get back its credibility," said Ingo Ramming, managing director of Dresdner Kleinwort Wasserstein's emissions business in London.

More than just trading profits are at stake. "This is the instrument that politicians choose to achieve climate change targets," Mr. Ramming said. If countries are serious about global warming, he added, "the regulation and framework needs to be right."

The trading of carbon credits — which polluters must buy to offset any excess emissions beyond the limits established by international treaty — has long been considered the driving force behind Kyoto and Europe's plan to reduce greenhouse gases. (The Bush administration has declined to participate in the treaty or the carbon market.)

In recent weeks, though, the market gyrations have prompted calls for swift restructuring from participants, environmentalists and government officials. One focus of the complaints is the release of data.

The most glaring mishap occurred in April, when some scanty information trickled into the marketplace; last Friday, more official data was mistakenly put onto a government Web site and then quickly removed — but not before it was noticed by market players.

In both cases, the market took a jolt because the information showed that European nations had overestimated the amount of carbon emissions their companies had produced.

Companies are assigned limits for their emissions of heat-trapping carbon dioxide, and they need to buy "carbon credits" if they want to pollute more. Alternatively, if they pollute less, they can sell their unused credits on the open market. The European Commission's official figures for 2005 were released on Monday, and they show that 21 of the 25 member states produced 44.1 million tonnes (45.92 million United States tons) less carbon dioxide, or 2.5 percent under the level that market participants had been operating on.

Taken on face value, this would seem like good news: after all, lowering carbon dioxide is the ultimate goal. But many participants say that governments, under pressure from industry, may have originally overestimated the amount of carbon credits their companies would need.

According to this view, the overestimation made it possible for these companies to sell their extra credits and make money without having to actually work hard to reduce emissions or improve efficiency to reach their Kyoto goals.

But with the excess in the carbon trading market, traders sold large batches of their credits, sending prices on a roller-coaster ride. With many players suffering significant losses, the experience threatens to drive out participants.

The emissions trading system is now facing criticism from several groups of advocates who usually take opposite sides: environmentalists and traders.

"Governments have been cheated by the big industries, which gave them the wrong assumptions for their emissions," said Stephen Singer, head of the European climate and energy policy unit of the World Wildlife Fund.

The emissions market is unique among financial markets in terms of the influence that governments hold over it. Government officials determine specifically which industries and which companies get how many credits.

Data about the actual carbon emission levels by companies began filtering out to the markets on April 25, more than two weeks ahead of a May 15 release date. Traders called the situation "chaotic."

Last week, an online database of the European Commission accidentally listed a complete set of European data on May 12, three days before the data were supposed to be officially released. Prices plummeted on Friday to 8.60 euros ($11) a metric ton, down from a high of 31 euros in mid-April.

Bankers say the government officials have not demonstrated a respect for normal market rules. This "is not a case study," said Mr. Ramming, at Dresdner Kleinwort. "We are trading in a real market with real money."

Any market is subject to volatility, of course, and the carbon emissions market is no exception. But it is thinly traded, with about 30 or 40 companies participating in any given day, and so it can be easily swayed.

One problem is that official data are released only once a year, rather than quarterly, monthly or even daily, as information in other commodity markets, like oil or copper, is released.

Now, banks and traders are calling for the European Commission to release emissions data on a quarterly basis, and to have the same oversight that any securities or bond market would, along with the same warnings and fines for leaking information.

So far, the permit market appears to have done more for the balance sheets of power companies than for pollution control. The market has lifted the revenues of power companies in the European Union by 15 to 25 percent, according to research at Point Carbon, a consultant firm based in Oslo that specializes in energy markets and emission trading.

"The electricity sector has had a very good year," said Kristian Tanger, research director at Point Carbon. "I don't think the system has been a big driver of energy efficiency."

No one is arguing for scrapping the market; indeed, it recovered somewhat on Monday, after the official data on emissions were released. Market participants said they were counting on governments to respond to the criticism about overallotments by reducing the amount of emissions their companies are allowed in 2008. Those allotments are to be reported to the European Union in June.

Despite the upheaval, many in the market are still optimistic about the carbon market. "Trading is the only way to reduce emissions economically and efficiently," said Louis Redshaw, head of environmental products at Barclays Capital. "I am confident this market will be around in 5 or 10 years."

Katrin Bennhold contributed reporting from Paris for this article.

Correction: May 18, 2006

The Market Place column in Business Day on Tuesday, about the carbon trading market in London, misstated the United States conversion for the 44.1 million tonnes reduction of carbon dioxide produced by 21 of the 25 countries in the Europe Union. It is 48.61 million United States tons, not 45.92 million.