Carbon Credit Trading : Prospects and Challenges an Indian Perspective

Shweta Gupta, Shachi Pareek

ABSTRACT

Our earth is facing a universal problem of global warming. This problem is largely the result of emissions of Carbon Dioxide and other Green House Gases from human activities including industrial processes, fossil fuel combustion and changes in land use. To reduce and overcome this problem of global warming, and to protect the earth from adverse effect of climatic changes, emission of carbon dioxide and other green house gases must be reduced significantly. To achieve this goal, concept of carbon credit came into vogue. The concept of carbon trading is a new and a practical approach towards environment conservation. On one hand, it is an approach of balancing human acts causing green house gas emission; while on the other hand, it offers a viable trading opportunity and helps develop the financial markets. For a developing country like India, Carbon Credit Trading presents good opportunities of trade with developed countries, thereby attracting more financial investors. Nevertheless, this kind of trade also suffers from the limitations of tax related frauds, doubtful connection from potential participants, environmental imbalance, deviation from basic approach and greater price sensitivity. This is a descriptive research paper, which highlights the intricacies of this trade and leaves great scope for further researches. Carbon trading being a totally new concept, it is not possible at present to collect considerable facts and figures on this topic.

Keywords

Carbon Credit, Global Warming

Carbon Credit: Concept

Carbon Credit can be defined as "a permit that allows the holder to emit one ton of carbon dioxide which can be traded in the international market at their current prices."

In simple words, whenever an industrial or any other manufacturing unit produces green house gases more than the permitted limit, it is required to bring it within the permissible limits. Such a unit has two options, either to upgrade the technology and reduce emissions or to buy carbon credits from the open market, so that it can get a legal right to emit green house gases beyond the marked ceiling. These credits are made available in the markets by the companies which undertake eco-friendly projects and do emit green house below the permitted limits.

India, being a Non Annex- 1 country (i.e. a country which has not committed to reduce Green House Gases effect in the period of year 2008-12) has a great scope for Carbon Trade.

Prospects of Trading of Carbon Credit

The following aspects reveal the benefits that India can reap from trading of Carbon Credits:

Trade with developed countries

US contribute 30% to the global emissions, while India contributes only 3% to the same. Thus, India is saving a lot on emissions and has got a vast scope to sell the credit certificates to the developed countries, which are exceeding their permitted limits.

Attracts more financial investors than companies

It has been observed that this kind of trading has drawn substantial attention of financial investors for the purpose of speculation rather than the companies to satisfy their working mechanism. It has offered yet another developing and major speculative market.

Scope for introducing corporate-run carbon funds

Just as Mutual Funds offer a portfolio about companies' shares, in the same way "carbon funds" may also be launched, which will comprises of carbon credits available with various companies. This is likely to attract more of retail investors.

Rapid growth of trade exchanges

In January 2008, MCX launched "Carbon Credit Futures" for the first time in India followed by NCDEX in April 2008. Carbon credits are possessed by large number of companies, but that does not mean that retail investors have no participation in this trade. They can well participate in this market and avail the benefit from the carbon price movement. Very soon this segment will witness other related institutions also, such as banks. This will spur the growth of such exchanges, which will give a boost to the nation's economy.

No fixed norms for emission reduction

In India, there are no fixed norms or limits for emissions. Thus, India will continue to be the supplier of carbon credits for a long period of time as compared to other western countries. Consequently, it will be able to fetch more trade from the European countries and markets.

Challenges of Carbon Credit Trading

Potential Participants

On the positive note, it is expected that the number of participants in this market are expected to increase, yet the expectation is doubtful on account of the extreme price sensitivity and complexity of this product. When the basis products like shares, mutual funds etc, fail to attract chunk of retail investors, it seems to be a daydream to find investors for carbon credits.

Environmental imbalance

This kind of trade is likely to create environmental imbalances. The companies which are producing excessive Green House Gases get more rights to produce emissions by simply paying money for getting the right to pollute the environment.

Deviation from the basic approach

The basic objective of introducing “carbon credits” was to develop an eco-friendly approach and to make the companies cautious about the level of emissions produced by them and helping them to reduce emissions as well. To the contrary, it has been observed that carbon trade is attracting more of speculators than genuine investors.

Greater price sensitivity

The price of carbon credits are greatly influenced by the factors such as:

- Supply-demand mismatch
- Policy issues
- Crude oil prices
- Coal prices
- CO_2 Emissions
- European Union allowances
- Foreign Exchange fluctuations
- Global economic growth

These factors make this trade riskier as compared to other securities.

Unethical Activities

Many industrial units in China have started producing green house gases artificially so as to earn Carbon Credits. The same situation is likely to arise in India as well.

Carbon Tax v/s Carbon Credits

There are still many arguments that support those industry producing Green House Gases should be charged with carbon tax on the quantity of fossil fuels being used by them, which is a rational basis for asking the companies to repay back to the environment. While on the other hand, there are other arguments which support carbon credit trading rather than carbon taxation. Taxation carries the risk of being disproportionately and unnecessarily charged if the emissions are less than the quantity of fossil fuels used. While carbon credit trading is an expensive proposition for the companies that pay a handsome amount for buying credit rights to pollute the environment instead of spending the resources justifiably.

Further, oil companies support carbon trading as a way to avoid making any cuts in oil production. This is totally against the interests of a common man.

Conclusion

In a nutshell, it can be said that the complexities involved in carbon credit trade exceed the potentialities of this trade. Thus, efforts should be made to reduce this complexity so that the real objective of environment conservation can be achieved and a viable investment opportunity is generated.

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