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Carbon markets – A distraction from the real priority: immediate emission reductions

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In discussions about climate, market interests are of course focused on finance and how the market can participate. In this context, market interests include not just carbon markets, but also land and commodity markets, mining, timber and paper, that hope to profit from offsets. There is a real risk that their increased participation could give market mechanisms, traders and investors more power over development and also over land than developing countries and their peoples. Before they will commit, market players want incentives to invest, voluntary standards, enhanced returns, reduced risk and guarantees against failure to deliver. Private investors want to greatly expand the carbon markets, where money can be made in the short term, in order to attract traders. They hope to gain from multiple market devices linked to claimed carbon sequestration or emission reductions. This briefing raises some of the issues that must be considered, especially by developing countries and their peoples.

Carbon markets are not about reducing emissions

So far, the expansion of carbon markets has not reduced emissions; in fact it has probably increased them.[1] International offsets allow high emitters to delay taking action to reduce emissions, yet rapid reductions are crucial if we are to address climate change. Stimulating and extending the carbon market will further increase the delay. In any case many offsets do not obey the rules, which means the projects from which they are sourced are not actually *additional* to what would have happened anyway. The fact that surplus emission allowances can be taken up by other parties, as a substitute for immediately reducing their own emissions, makes it even more likely that the carbon market will increase global warming. The carbon market is set up primarily to enable participants to profit from emissions trading, not to reduce emissions. The financial crisis reduced emissions more sharply and effectively than policies have done to date, but bailing out the banks that caused it has drained many government coffers.

1 Bad Deal for the Planet: Why Carbon Offsets Aren't Working...and How to Create a Fair Global Climate Accord, International Rivers, 2008

Locked in to the carbon economy

How many governments are really committed to change over the long term? Most of them are currently locked into the carbon (fossil fuel) economy and are strongly lobbied by the private sector not to shift away from it. Plenty of political courage is required to make the fundamental changes required. The big investors, including those who invest over the long term such as pension funds, are already deeply committed to the carbon economy and unwilling to take risks with alternatives. So the challenge is great - but the cost of not responding is far greater.

Comparing costs of responding to climate change with military spending or bailing out the banks

A number of organisations including International Emissions Trading Association (IETA), International Energy Agency (IEA) and International Chamber of Commerce (ICC) conclude that we need up to one trillion (1,000,000,000,000) US dollars per year for the "transition to a low carbon economy", while in 2009 the UN Department of Economic and Social Affairs recommended a new Marshall Plan with funding of more than US$ 500 billion a year.[2] To put this in some kind of perspective: according to a recent report from the IEA, global fossil fuel subsidies are currently worth more than US$ 550bn (US$ 0.55 trillion) a year.[3] Global military spending for 2009 was close to US$ 1.5 trillion.[4] Finally, it is estimated that the recent bank bail-outs cost taxpayers around the world US$ 6.9 trillion.[5] So it is clear that cutting fossil fuel subsidies and shifting expenditure away from banks and military spending could yield a large amount of funding. It is also clear that large sums of money are no substitute for commitments to emission reductions and equitable long-term policy frameworks.

However, will governments phase out fossil subsidies and reduce military spending? Will they make the long-term policy commitments required to shift away from a fossil fuel economy? This seems highly unlikely. They have certainly not done so yet. Their emission reduction

2 http://www.un.org/apps/news/story.asp?Cr=develop&Cr1=climate+change&NewsID=31910
3 http://www.businessgreen.com/business-green/news/2265406/leaked-g20-text-suggests
4 http://www.globalissues.org/article/75/world-military-spending
5 http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/3274135/Bank-bail-outs-cost-taxpayers-4473bn.html

commitments under Kyoto are totally inadequate. Their financial commitments are similar: under the so-called Copenhagen Accord only US$100 billion (0.1 trillion) by 2020 was mentioned. And this would not be a gift; it would be "mobilised" through international finance institutions and bilaterally, and would come with strings attached, and as loans rather than grants. Annex 1[6] countries do not want to commit funds or transfer technology, they would prefer to resort to the market. Some would like to move away altogether from mandatory emission reductions towards carbon trading in voluntary markets.

Attracting the market

Markets require incentives to invest, guarantees in case of problems, enhanced, short-term returns and reduced risk before investors can be attracted. Proposals include:

- "Fast start" finance: This is the up-front money governments are meant to contribute to tackling climate change. Countries in the global south demand these commitments by Annex 1 countries and they are meant to be additional to current overseas development aid. This finance is also meant to be in the form of grants, not loans. And it should target Least Developed Countries (LDCs) and Small Island Developing States (SIDS) first. However, it is turning out to be neither fast, nor additional nor enough.
- "Market start up": of course market interests and corporations also want this kind of contribution from governments, to help to establish the market before they will commit to becoming involved.
- Long-term finance for low carbon development could be raised in the form of financial instruments such as bonds. Bonds may be issued by governments, international institutions and corporations, with the commitment to repay the bond, often with interest, over a certain period of time. Private and public pension funds and other institutional investors are seen as the kinds of investors who will put their money into the bonds over the long term.[7]
- There are a number of proposals for climate-related bonds, some of which (eg: Green Sectoral Bonds [8]) are potentially very dangerous to developing countries, as these bonds would be "fully commoditisable and tradeable" and developing countries would be liable for failure to fulfil bond conditions, a neat reversal of where the real responsibility lies. However, with other funding difficult to access and in the absence of developed country funding commitments, developing countries might be tempted.
- Proposals have also been made to attach carbon credits to bonds, for the private sector to trade and profit from in the short term, in order to attract their interest.
- Governments are also expected to create the legal and policy frameworks to provide security and stimulate the market, eg: targets and subsidies, as they have done for agrofuels.
- If the same market practices are allowed to continue as before, it is very possible that offsets would be turned into bundles including high and low risk investments and sold on the derivatives market, as were subprime mortgages, so risking a sub-prime carbon market.
- Countries could be required to pledge "carbon collateral", based on verified measurement of their current emissions, before they could access finance, eg: as proposed for Green Sectoral Bonds.

The CDM – fit for the market's purpose?

So far the Clean Development Mechanism (CDM) has required considerable resources and time to implement projects but has yielded comparatively little. So-called project-based transactions as a result of CDM topped US$6.5 billion in 2008 but fell to US$2.7 billion in 2009.[9] CDM is also considered by some to lack transparency and coherence. And LDCs benefit particularly little from it. Current CDM beneficiaries are mostly projects related to industrial gases such as hydrofluorocarbons (HFCs)[10] and N2O, but also include biogas from swine manure in large industrial livestock units as well as heat generation from palm oil mill effluent. Here CDM has the effect of validating polluting industries.

The EU Emissions Trading Scheme is highly dependent on CDM's Certified Emission Reductions (CERs), which are carbon credits as issued by the CDM. Now questions are being raised about the "gaming" of the system with respect to methodologies for the abatement of ozone-depleting gases. Other methodologies of CDM, together with issues relating to transparency and conflicts of interest are beginning to come under serious questioning. All this suggests that the CDM is unsuitable both for the market's needs and, more importantly, for tackling emissions.

Yet there are moves to expand CDM and speed up the process, moves that are supported by some developing countries – but we should not forget that the CDM is a market mechanism. Any attempt to expand it or replace it by something larger, faster, with fewer rules and more flexibility would be dangerous in view of the many still unsolved problems with CDM.

6 Parties to the UNFCCC with the largest responsibility for carbon emissions to date, such as the US and the UK, are part of a group called Annex 1. Non-Annex 1 parties are mostly developing countries. Most members of Annex 1 "are required to provide financial resources to enable developing countries to undertake emissions reduction activities under the Convention and to help them adapt to adverse effects of climate change". The term Annex 1 countries is therefore used here to describe those countries with such obligations.

7 Definition of bond: see for example: http://www.investorwords.com/521/bond.html

8 Institute for Agriculture and Trade Policy: The New Climate Debt: Carbon Trading Wrapped in a Green Bond. www.iatp.org.

9 State and trends of the Carbon Market, World Bank, May 2010

10 HFCs are meant to be alternatives to ozone destructive CFCs, but can be potent greenhouse gases themselves.

CDM and LULUCF

In land use, land use change and forestry (LULUCF), CDM credits for 'afforestation and reforestation' projects include monoculture tree plantations. It is proposed to continue such CDM credits and some would like to increase them. There are also proposals to include forest, cropland and grazing land management, soil carbon and other land use in the CDM.[11] If approved, this would provide major new carbon finance for monoculture tree and crop plantations of all types and such projects would be "hosted" in developing countries. Annex I countries are also trying to set baselines and other criteria that would enable them to increase, not reduce, their emissions from land use activities. They should not be allowed to side step their commitments through such offsetting. Proposals have also been made to include CDM offsetting in REDD.

Carbon price – too low and unstable

In theory at least, carbon readily lends itself to function as a unit for measurement, a currency or a commodity. Making carbon a commodity or a kind of currency, means that the price constantly changes, according to the rules of markets. Currently, the price remains low but is also highly volatile. This is not surprising, as there has been no serious commitment by developed countries to meaningful emission reduction targets. Furthermore, overgenerous offset allowances add to the problem. The infrastructure and technology elements needed for a low carbon world are currently more expensive than those for a fossil-fuelled world (because most of the infrastructure for the latter already exists). Rather than turning carbon into a market commodity, we need new models of development that do not depend on limitless energy inputs and economic growth, thus a complete reversal of current models. We would then need large scale, long-term, collective commitment in order to achieve implementation over the long term.

Biomass energy - the easy option?

Instead of taking the difficult decisions to reduce the energy density of our economies, many governments prefer to turn to so-called "renewable" sources of energy. Currently the cheapest and easiest alternative is to derive energy from biomass. Of course biomass has been the main source of energy for millennia, but now the plan is to make it central to industrialised energy infrastructure, fuelling vehicles and providing heat and power. Many interests and governments are choosing to promote the notion that we can replace fossil fuels with fuels derived from biomass, even though it is clear that the impacts on climate, biodiversity, communities, food security and sovereignty, as agrofuels have shown us, are severe and it is simply not possible to produce the amounts that would be required.[12] Yet the EU and the US are providing incentives to use biomass, through targets and tax breaks. The idea is to attract a variety of markets, including the carbon market, but also commodity markets involved in biomass, agriculture and land, plus technology markets. By promoting certain approaches as methodologies for the CDM and offsets, companies can supplement their profits with income from carbon markets, thus perhaps making the biomass option viable economically in the short term - but ecologically, this would be highly destructive.

The push to extend carbon markets to soil and agriculture

There is now a strong push to extend carbon markets to new areas, particularly agriculture and soils. The first soil carbon project for Africa was announced in November 2010.[13] Some argue that this extension is essential because of the need to take into account the severe impacts of agriculture on forests, for example, but this is no excuse to extend a flawed approach to new areas. Moreover, the current focus on attracting the private sector as a source of finance would likely give corporations, institutional funders and private investors new powers, such as ownership of the carbon in forests and soils. This has very serious implications for land rights, indigenous territories and rights, peasant farmers, food production and sovereignty, as well as biodiversity and ecosystems. If governments were to commit themselves collectively and over the long term, according to their "common but differentiated responsibilities", to equitable policy frameworks on energy, land-use, land rights, and funding, this would provide a far more stable basis for the future and would also help to rebuild the trust that has been so seriously eroded.

Justice and equity

The current economic model, based on high levels of resource consumption that are destructive to ecosystems, local communities and biodiversity, is unsustainable. It also causes and accelerates climate change, for example, the destruction of ecosystems to produce export commodities and food luxuries in monocultures, plus the associated infrastructure and energy requirements of a model of consumption based on international trade, controlled by corporations, wasteful of resources and energy intensive. We must change the inequitable social models generated by this economic model. If we are to keep global warming to around 1.5C, there has to be an upper limit to the level of CO2 emissions, yet high consumption countries continue to use more than their fair share of this atmospheric space. Markets enable them to continue this pattern of high per capita emissions while

11 Draft proposal by the Chair to facilitate preparations for negotiations FCCC/KP/AWG/2010/17, 5 Nov 2010 page 21, para 8

12 For example: Agrofuels: towards a reality check in nine key areas: www.econexus.info

13 First-Ever African Soil-Carbon Deal Signed at Hague Investment Fair: http://www.ecosystemmarketplace.com/pages/dynamic/article.page.php?page_id=7813&section=carbon_market&eod=1

shifting the burden of reducing emissions to developing countries. This means that developing countries are denied still more of their due share of atmospheric space. This in turn perpetuates and exacerbates old divisions and inequalities, taking them to new levels of injustice.

What should developing countries and their citizens beware of?

The need for finance must not make countries and peoples forget some basic issues:

- We are currently on course for highly inequitable sharing of the remaining atmospheric space for emissions.
- Markets facilitate this continued inequity by allowing high emission countries to offset emissions in developing countries.
- As well as being inequitable this does not lead to emission reductions.
- The loopholes in the Kyoto Protocol enable industrialised countries to continue on this path. They include using carbon sinks such as forests to justify continued emissions and they also involve offset credits accumulated through the CDM and Joint Implementation, plus surplus emission credits especially in Russia and Ukraine.
- These basic loopholes risk being compounded, for example through current proposals for LULUCF.
- Developing countries would be liable for any debts incurred but would have no control over the market.[14]
- Carbon ownership versus land rights: investors might seek control over the carbon they are paying to avoid emitting or to sequester, with direct impacts on land rights, indigenous rights and sovereignty of every kind, in addition to further land-grabbing.
- Developing countries and their citizens could be caught in a new variation on debt bondage through these market proposals.
- Extending voluntary market initiatives will expose developing countries to increased risks.
- Annex 1 countries must comply with their commitments and obligations to reduce emissions, rather than simply transfer their reduction obligations to developing countries.

Conclusions

The market approach is unsuitable as a basis for moving away from the carbon economy and is likely to lock us into a "Business As Usual" scenario, leading to runaway global warming. What we need is long-term commitments to honest climate policy on all sides and the firm commitment of sufficient public finance for development, deployment and diffusion of viable low carbon technologies to give business and investors clear signals on where future profits lie. Business needs to be constrained by government and compelled to take a long-term approach to the issues.

It may be useful to briefly consider why the Montreal Protocol on substances that deplete the ozone layer succeeded where the Kyoto Protocol is currently failing. A major reason is that Montreal made good economic sense to the US and US companies, while Kyoto doesn't. In addition, the public responded actively to the issue of ozone depleting substances, strongly reducing their use of aerosol sprays, whereas consumers have yet to indicate a strong commitment to climate related action. However, it is also clear that climate change challenges the basis of our economic model and its re-creation of the citizen as consumer, so the challenges and the commitments required are much greater. In addressing climate change, we must build public trust and commitment to an equitable solution, in order to pressurise government. At the same time it is clear that public action and commitment by itself is not enough and governments cannot solve the problem by attempting to shift the burden to their citizens.

Trust and commitment must be built first, and the developed countries must take the initiative here. Proposals from business to use markets may benefit business, but it is likely that this would be at the expense of the climate, biodiversity, food security, justice and equity. In fact markets are a dangerously seductive distraction from the real issues – how to convert a carbon-based growth economy to an economy that operates within ecological limits.

Further reading – a sample:

Carbon Trading: How it works and why it fails, Carbon Trade Watch, 2009. http://www.carbontradewatch.org/publications/carbon-trading-how-it-works-and-why-it-fails.html

Series of factsheets on carbon trading: http://www.carbontradewatch.org/factsheets/fact-sheet-2-carbon-offsets.html

Critical Conversation, Privatisation and Power, by Larry Lohmann, The Corner House, 2006: http://www.thecornerhouse.org.uk/resource/carbon-trading-0

When Markets are Poison: Learning about Climate Policy from the Financial Crisis, by Larry Lohmann, The Corner House: http://www.thecornerhouse.org.uk/resource/when-markets-are-poison

Agriculture and Climate Change: Real Problems, False Solutions, by EcoNexus, Biofuelwatch, Grupo de Reflexion Rural, NOAH - Friends of the Earth Denmark, and The Development Fund Norway (www.econexus.info)

14 Institute for Agriculture and Trade Policy: The New Climate Debt: Carbon Trading Wrapped in a Green Bond, and Speculating on Carbon, the next Toxic Asset. www.iatp.org