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Global Warming: No Easy Fix

Policymakers have settled on 'emissions trading' as their favorite global-warming fix. But it isn't working.

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March 12, 2007 issue - Global warming isn't the only debate that may be over. Governments and policymakers around the world also seem to have settled on a solution. "A responsible approach to solving this crisis," Al Gore said recently at New York University's Law School, would be "to authorize the trading of emissions ... globally." Emissions trading, also called carbon trading, is being expanded in the European Union and Japan. And in many places where it's yet to take hold, like Sacramento, Sydney and Beijing, politicians are embracing it. Nicholas Stern, former chief economist of the World Bank and Europe's foremost political expert on global warming, predicts that the value of carbon credits in circulation, now about \$28 billion, will climb to \$40 billion by 2010.

This should be great news for the environment, but many experts have their doubts. The notion that emissions trading is going to make a significant dent in global warming is deeply flawed, they say. Current emissions-trading schemes have proved to be little more than a shell game, allowing polluters in the developed world to shift the burden of making cuts onto factories in the developing world. Too often factory owners use the additional profits banked from carbon credits to expand their dirty factories. Even more worrying, emissions trading may have set back the battle against climate change by diverting investment from renewable-energy technology, which arguably is essential to any long-term solution. So far, the real winners in emissions trading have been polluting factory owners who can sell menial cuts for massive profits, and the brokers who pocket fees each time a company buys or sells the right to pollute. "Carbon trading is a promising strategy for reducing greenhouse-gas emissions," says Dan Esty, director of Yale's Center for Environmental Law and Policy, "but the current structures have serious flaws."

Part of the appeal of emissions trading is that it is a market mechanism that's easy to implement. By turning the right to release greenhouse gases into a commodity that can be traded like gold or sugar, governments need only set caps on the amount of pollution they'll allow and let the invisible hand of capitalism do the rest. But emissions trading is proving to be a grossly inefficient way of cutting emissions in the developing world. For instance, under the Kyoto Protocol, the U.N.-brokered agreement that set limits for carbon and other emissions, companies in nations with Kyoto targets can avoid making expensive cuts to their own emissions by paying companies in countries like China to make cuts instead. This approach has been a boon to developing-world factory owners and international brokers, but the impact on the environment is more ambiguous. Since developing countries don't have any caps on emissions, companies can take the handsome payments they receive from carbon cuts and use the money to build new fossil-fuel and coal factories. India's Gujarat Fluorochemical, for instance, made €27 million in the last three months of 2006—triple its total company earnings compared with the same period in 2005—thanks to carbon credits. That boost in profits will no doubt help fund its new plant for making Teflon and caustic soda, both polluting substances.

One reason emissions trading is so politically popular is that it's vulnerable to lobbying. The European Union's Emissions Trading Scheme, which accounted for two thirds of the global carbon trading that went on last year, or \$20 billion, is a case in point. On paper, the scheme is a zero-sum game: the European Commission issued a limited amount of carbon credits. These caps are supposed to bring emissions down across the EU to a level 8 percent below those of 1990 by 2012. But most European governments, under pressure from lobbyists, were too generous in handing out targets to specific industries. As a result, many companies weren't forced to make any cuts, or buy any credits. Indeed, in May 2006, when inspectors began checking the books, they found a surplus of carbon credits which, as soon it became public, triggered a market collapse.

The scale of the inefficiency of emissions trading was revealed in a study published in the scientific journal *Nature* last month. The nearly \$6 billion already spent on projects to curb emissions of HFC-23, a potent greenhouse gas, had the same impact on the environment as would \$132 million worth of equipment upgrades. Last year companies in Kyoto countries paid about \$3 billion to some of the worst carbon polluters in the developing world. What impact did this money have? Shri Bajrang, an iron factory in a gritty stretch of

flat scrubland near Raipur on the main route between Mumbai and Kolkata, is a typical case. In the nearby village of Bendri, the morning sun is barely discernible through the acrid haze, the trees are black with soot and women wash clothes in polluted ponds. Respiratory illnesses such as tuberculosis, which now afflicts about 15 percent of the locals at the village, are on the rise. Last year, to generate carbon credits it could sell to European firms, the factory's owners fitted the plant with waste-heat-recovery boilers and turbine generators, which will reduce the amount of pollution it releases by 107,000 tons a year for the next decade—which Shri Bajrang puts at 12 percent of its total emissions. "Put bluntly, the [United Nations'] carbon-credit scheme is a failure," says Larry Lohmann of London-based environmental and social-justice think tank Corner House.

Emissions trading has also failed to stimulate investment in new green technologies. While trading funnels billions of dollars of international environmental investment money into companies like Shri Bajrang, renewable-energy projects aren't receiving funding because they're more costly. Indeed, only 2 percent of the United Nations' trading projects involve renewable energy like hydro dams and wind farms, and communities that preserve forests and follow other ecofriendly practices are ignored. "The only solution is to stop the industry," says Ram Naran Nishad, a farmer in Bendri whose tomato yields have decreased by 70 percent since the factory's arrival.

Many experts think a carbon tax would be the better alternative. It's more straightforward and jargon-free, and would prevent much of the "gaming of the system" that's plaguing carbon trading. The problem, of course, is that new taxes are unpopular with voters. "A carbon tax would be far superior," says Yale's Esty, "but trading is a good second-best solution."

Legislators around the world are trying to fix the current trading schemes. Europe has set stricter carbon quotas for next year, U.S. politicians are talking about auctioning carbon credits instead of giving them away, and U.N. officials want to beef up renewable-energy projects. Emissions trading will succeed to the extent that world leaders can muster the political will to make the caps strict, and make them stick.

With Chris Stowers in Raipur

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