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## The Market to Clear the Air

The growing trade in carbon emissions offers hope as a pollution solution

By Marianne Lavelle

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It's not enough money-yet-to stop polar ice caps from melting, but the pot has been sweet enough to lure Wall Street bankers into the fight against global warming. Nearly \$23 billion will change hands this year on a new market that the European Union has created in a bid to save the planet through free enterprise. That's more than double the value in 2005, the inaugural year of the Emissions Trading Scheme.

The market, based on a U.S. system that has curbed acid rain pollution, creates a financial incentive for cutting carbon. The 37 participating developed nations set limits on carbon emissions and hand out allowances to industry. Companies that cut their use of oil, coal, and natural gas can sell their spare allowances to firms hard pressed to reduce emissions. When former World Bank chief economist Nicholas Stern told the British government this fall that climate change was "the greatest market failure the world has seen," he pointed to the European system as "leading the way" toward a possible solution. But Stern and others would like to bring under the tent the world's No. 1 source of the harmful emissions, the United States.

Early on, the Bush administration rejected the Kyoto Accord, the international treaty to limit carbon dioxide and other "greenhouse gases" that trap solar heat and raise Earth's temperature, increasing the chance of floods, hurricanes, and drought. But many European market players believe the Democrats' victory in the midterm elections will create momentum for U.S. involvement, perhaps before the first phase of treaty commitments expires in 2012, says Mark Woodall, chief executive of Climate Change Capital in London, the largest carbon investment bank.

**A deal?** Republican Sen. John McCain thinks President Bush's view has shifted and that he'd sign a measure like the bipartisan carbon cap-and-trade bill McCain has crafted with Connecticut Sen. Joseph Lieberman. But many Democrats don't like that bill's pro-nuclear energy provisions. A long slog is certain, since the Democrats have to garner substantial GOP support in the closely divided Senate.

While Washington debates, activist governors of both parties may forge the first U.S. ties to international carbon trading. Seven northeastern states have agreed to put into place a cap-and-trade program to limit power plant emissions beginning in 2009. And California Gov. Arnold Schwarzenegger announced in October a market approach to implementing the state's new carbon law; he has signed an agreement with British Prime Minister Tony Blair to work toward connecting with the European system.

If so, they'd be joining in on a volatile market that has drawn an array of brokers, bankers, and arbitrageurs who make money on the gap between the costs of greenhouse-gas reduction projects and the current price of carbon allowances. That price rose steadily early in the year to nearly \$40 per ton of carbon, then tumbled hard in the spring to less than \$12 when it was revealed that several European

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governments had been too generous with their industries when handing out allowances.

The market recovered somewhat in summer but slumped again this fall along with energy prices. The price has been lolling around \$12 a ton in recent weeks, way below the \$85 a ton that economist Stern believes is the real cost to society of pollution from carbon.

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