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The Market to Clear the Air

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The low price has driven participants to seek cheap solutions. A company or country can gain credits (with the approval of a United Nations oversight body) by investing in a carbon-reduction project in one of the world's poorer countries. Thus countries like China and India, under no obligation to cut carbon emissions under Kyoto, are the scenes of hundreds of environmental projects.

U.S. agricultural giant Cargill has invested in a project to capture methane gas from the wastewater lagoons on the farms of the largest pig producer in Mexico. Cargill's goal is to generate both carbon credits and electricity—a natural progression, its executives say, for a company that began 141 years ago as an agricultural commodities trader. "We believe CO₂ is a commodity that over time will trade no different from natural gas, fuel oil, or any other futures in the financial markets," says Eugenio Meschini, managing director of Cargill Emission Reductions Services.

The project market is dominated by new facilities in China designed to capture and incinerate HFC-23, a greenhouse gas 11,700 times as potent as carbon dioxide. A waste byproduct in production of the refrigerant chemical HCFC-22, it is typically vented to the atmosphere. China is taxing 65 percent of project revenues to fund renewable energy investments; the World Bank, which has helped broker the largest such deals, says they demonstrate China's engagement on climate change. But some environmentalists criticize the projects as offering a perverse incentive to create more capacity for manufacturing HCFC-22, which is an ozone-depleting chemical.

Debates have arisen over nearly every type of carbon project. Trees absorb carbon dioxide, but the U.N. oversight board hasn't settled on how to measure the benefits of forestry. Little investment goes into expensive wind and solar energy. "The price of carbon is not enough to support those projects right now, if you can't get a favorable electricity price as well," says John Deacon of the London office of the U.S. law firm Hunton & Williams, which advises clients on carbon projects. In many countries that would be suitable for wind power, such as South Africa, governments hold down the price of electricity to help the poor. Energy developers couldn't make a return, unless the carbon credits they'd generate were more valuable.

"We're in search of standards," says Richard Sandor, chief executive of the Chicago Climate Exchange, a voluntary marketplace that mirrors what is going on in Europe. "Some things experimented with might not stand up two years from now, and some will. ... One should not expect a perfect product with any new invention." Goldman Sachs showed it has enough faith in carbon trading that in September it bought a 10 percent share of the holding company that owns both the Chicago exchange and the largest trading platform overseas, the European Climate Exchange.

Bets in billions. Another Wall Street vote of confidence: In October, Morgan Stanley announced it would invest \$3 billion in the carbon market over the next five years—the largest single investment to date. An additional \$7 billion is invested in more than 50

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"carbon funds" worldwide, says Guy Turner, director of New Carbon Finance in London. Half the money comes from governments looking to meet their Kyoto targets and the other half from private and institutional investors like pension funds-with nearly 30 percent of the private money managed from the United States.

Despite all the activity, there's something notably lacking. "I have found it difficult to identify any substantial real investment in either emissions-reducing or efficiency technology in Europe," says Tony Ward, head of Ernst & Young's power and utilities group in London.

Point Carbon, an Oslo-based market analysis firm, estimates that about \$5.2 billion will go into carbon reduction projects this year in poor countries. But banker Woodall estimates \$50 billion a year is needed to make a dent in climate change. He's optimistic, noting that the world's No. 1 producer of carbon emissions also happens to be the largest source of capital. "A huge amount of investment would be available," he says, "if the international community got to grips with the problem-including the United States."

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