

Don't COP out on climate change: When environment meets finance

By Wayne Visser

There are only two inappropriate responses to the impasse between the United States and the rest of the world over climate change action, initiated by newly elected oilman George W Bush's withdrawal from the international Kyoto Protocol agreement. Namely (1) inaction and (2) distraction.

The biggest error of judgement that anyone could make right now is to think that the ongoing political football on climate change is going to stop, or even slow down, the inevitable onset of a global carbon-constrained market.

Not only do 181 countries still have commitments under the United Nations' Framework Convention on Climate Change to *do* something, but now there is an even more powerful force than politics that has taken over in climate change developments - economics and finance!

The commercial and financial world has cottoned on to the reality of a greenhouse gas (GHG) restricted future. Hence, the race to make money (or at least not to lose great wads of it) is already being run at break-neck speed. While the politicians are squabbling in Laurel and Hardy fashion, multinationals, banks, brokers, insurance companies, auditors, certifiers and consultants are all doing the rational thing: preparing to be first-to-market, or at least early-adopters.

This article gives a potted selection of examples of things that have happened just over the past year, which show that the formerly disparate disciplines of environment and finance are about to merge 'big time', if they haven't already. And climate change, more than any other issue, is responsible for this strange marriage.

Countries vulnerable to the effects of climate change have been the first to feel the economic bite, and through them, large insurance companies like Swiss Re and Munich Re. According to Dr Andre Dlugolecki, director of the world's sixth largest insurance company CGNU, 'damage to property due to global warming is currently rising at 10 percent a year and could bankrupt the world by 2065'.

Even if that sounds a bit dramatic, the numbers speak for themselves. Over 1999/2000, economic losses from weather-related natural catastrophes totalled \$130 billion, of which insurance companies paid out \$37.5 billion. Indeed, our neighbouring Mozambique floods were part of these tragic numbers.

But the banks and insurance companies are busy turning this threat into a business opportunity as well. The market for weird new financial instruments called 'weather derivatives' and 'catastrophe bonds' has boomed in the past year, with the World Bank's International Finance Corporation and numerous private companies such as Societe Generale (SG) joining the game. SG, for instance, has six weather-related funds with \$300 million under management.

In fact, the variety of GHG related financial funds on the market is already mind-boggling. The project-based World Bank Prototype Carbon Fund is the most well known, but numerous others, such as the United Air Fund (UAF), already exist. The UAF is designed to give developing countries a financial incentive to reduce carbon emissions. Essentially, it allocates clean air credits (called ShAIRs) to developing countries, which can then be exchanged for low-emission technologies from the industrialised world.

Financial brokers are not being left behind either. In a strategic move, Mitsubishi Corp, which has 600 subsidiaries spread around the globe, announced its investment in US energy brokerage Natsource. The joint-venture will broker deals in the electricity, weather derivatives and emissions markets. Natsource believes that the international GHG trading market could be worth \$200 billion a year.

Financial advisors of all shades are also feverishly preparing. The international auditing firms and certification companies are testing methodologies for auditing and certifying GHG data. Others, such as Innovest Strategic Value Advisors, have launched services to assess the potential impact of companies' GHG emissions on their share price. According to Innovest, the discounted present value of potential carbon liabilities can represent as much as 40% of a company's market capitalisation.

Even e-commerce has not left the climate change arena untouched. Sites such as CO2e.com have already hosted GHG transactions via online trading platforms. In the first such deal, Ontario Power Generation bought 1.3 million tonnes of GHG reductions and GEMCO bought an option on 600,000 tonnes of reductions, both from Houston-based Petro Source Carbon Company.

Naturally, wherever there are new global practices, the call for standardisation soon follows. Already, the International Standards Organisation (ISO) is considering developing a standard on GHGs, while the US Financial Accounting Standards Board has begun exploring the need for an independent body to set carbon accounting and certification rules.

It is not just the profit hungry financial companies that have responded to the carbon market challenge. Progressive companies, some of whom are themselves significant GHG emitters, are backing the trend. For example, seven multinationals have joined together in The Climate Change Partnership, with the aim of promoting the development of carbon markets.

These companies include: UK energy groups BP and Shell, Canadian aluminium company Alcan, US chemicals giant Du Pont, Ontario Power Generation, French aluminium company Pechiney and Canada's Suncor Energy. In 1990, their combined GHG emissions were 360 million tonnes and they have set targets that will collectively reduce these emissions by 80 million tonnes by 2010.

BP has gone even further and is offering its expertise in GHG emissions management to other companies that are likely to participate in the UK market in GHG emissions allowances. This, on the back of their own experience in designing and operating an internal GHG emissions trading system in BP since September 1999.

The UK national emissions trading system (ETS) referred to above has already been set up and will allow voluntary participation by companies beginning in April 2002. Importantly for South Africa, the ETS makes provision for credit trading from international projects. Norway and other European countries appear set to follow suit, in anticipation of the regional European Union ETS that is planned for launch in 2005.

More traditional fiscal approaches are also already in use, such as the UK's Climate Change Levy (CCL), launched in April this year. The CCL is a tax on the industrial use of energy that will raise fuel bills by between 5 and 10 percent. Some energy-intensive sectors, however, have been offered up to 80% discounts on the Levy if they agree to sign up to energy efficiency improvements or emission reduction targets.

Finally, environmentally conscious consumers and lobby groups are also not waiting for the politicians to reach agreement before they put pressure on companies that are slow to respond to the climate change threat. Witness, for example, the current call by Greenpeace to boycott the products of Exxon-Mobil, Chevron, Texaco, Conoco and Phillips, due to their conservative stance on climate change and the Kyoto Protocol.

At the end of the day, it's not just about financial institutions getting in on climate change to make money out of a global misfortune. It's about finding the least-cost way to solve the problem, ie to stabilise GHGs in our atmosphere. We know that the longer we delay now, the higher the remediation costs will be later. And there is a strong case to suggest that using flexible market instruments, such as emissions trading, is a cost effective and efficient approach.

For example, in a simulated GHG emissions trading scheme hosted by the International Energy Agency, all 17 participating countries were able to meet their GHG reduction targets (which were comparable to those in the Kyoto Protocol) and compliance costs were 60 percent lower than could be achieved through domestic action only.

No doubt, this has been an discomfoting article for environmentalists, who fear that the integrity of their cause will get lost in the storm of emerging carbon financial markets. Perhaps it is disconcerting for industrialists also to know that they cannot simply wait-and-see, since their competitors and their financiers are already moving ahead with action.

Of course, most of us working in this field hope that the Kyoto Protocol *will* go ahead in some shape or form. And in the next issue of *Resource*, I will look at where COP-6-II (happening 18-27 July 2001) leaves us on this score. But whatever the outcome, the basic message won't change: Rather than twiddle your thumbs, get your hands dirty preparing for the carbon-constrained future.

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