Governance as Corruption

Carbon Trading and Financial Derivatives

Athens
November 2008
A SHARED HISTORY
Crises of overproduction → outsourcing, liberalization, globalization → need to manage new uncertainties → derivatives boom → liquidity needs, financial liberalization → speculative capital begins to dominate a global market for abstract “risks”

State balancing role becomes difficult ↔ “private regulation” (Alan Greenspan)
Global outstanding financial derivatives

By far the world’s biggest market . . . started from close to 0 in the 1970s.
Crises of overproduction, crises of legitimacy

\[ \rightarrow \] Climate change presents new opportunity for “legitimized accumulation” \[ \leftrightarrow \]
translation of long-range structural change required for shift from fossil fuels into exchange of individuated climate benefit units

\[ \rightarrow \] liquidity needs \[ \rightarrow \] creative accounting producing new pollution rights

“Marketization of governance”: “What is the best way to tackle climate change? If we have a global carbon price, the market sorts it out.”

*Matthew Whittell, Climate Exchange plc*
Also projected to become the “world’s biggest market”... started from close to 0 in the 1990s.
Shared architects . . . not a coincidence

Interest rate derivatives (1970s)
... Richard Sandor

Pollution trading (1990s)
... Richard Sandor
CONSTRUCTION OF THE COMMODITY
“Efficiency” means commensurating, “objectifying” and making abstract uncertainties, relations, places, technologies and methods, so they can be exchanged at a mass scale, absorbing and multiplying speculative capital and enabling pyramids of leverage

But that entails unverifiability, scientific unsoundness → credibility challenges → increasing complexity and mathematization → decoupling from fundamentals → no one knows what anything is worth → fraud cannot be distinguished from non-fraud even in principle (carbon market) → genuine regulation is impossible (→ bubbles? → collapse?)
“A lot of people . . . making a lot of money out of carbon trading . . . want to perfect the market rather than press for the changes that are actually needed.”

Tom Burke, E3G,  
25 September 2007
This conference “does not really concern itself with broader climate change issues … It is aimed squarely at investment banks, investors and major compliance buyers and is focused on how they can profit today from an increasingly diverse range of carbon-related investment opportunities. … Hybrid and complex carbon credit structured products … how to identify investor demand for them in the US … derivative/synthetic carbon products … carbon linked notes … for Japanese retail investors … sub-index arbitrage strategies … productising carbon … access channels for producers, … speculators, proprietary traders and investors. … The programme features Sindicatum Carbon Capital, NatSource Asset Management, Natixis Environnement & Infrastructures (European Carbon Fund / European Kyoto Fund), Credit Suisse, Barclays Capital, IDEACarbon, New Carbon Finance, ICF International. …”
These two markets’ need for numbers, “equivalents” and “low transaction costs” → sophisticated math that, scientifically speaking, puts the cart before the horse, relying on false premises/misunderstandings.
“For the mathematics to work it is necessary to make assumptions that disregard the real financial world and the principles of mathematical statistics.”

Edward LiPuma and Benjamin Lee, 2004

“[S]ystemic risk . . . is structurally impossible to determine because the risk models currently in use are designed to determine derivative and lending exposure only one institution at a time.”

Edward LiPuma and Benjamin Lee, 2004
Project baselines “cannot be measured.”

Carolyn Fischer, 2005

“If you are a good storyteller you get your project approved. If you are not a good storyteller you don’t get your project through.”

Lambert Schneider, Oko Institut, 2007
Decoupling from underliers (in derivatives): example

Repackaging as collateralized debt obligations, etc.

Pooling different kinds of objectified uncertainty and risk

Mortgages, credit card balances, car loans, etc.
Decoupling from fundamentals (in carbon trading)

- Pooling further “equivalents” (OFFSETS) for additional cost savings and delays in addressing lock-in
- Pooling “equivalent emissions” by abstracting from place, technology, history (TRADE)
- Refiguring as modest progressive numerical GHG cuts (CAP – state-regulated)
- Dealing with climate change: initiating new historical pathway to overcome fossil fuel lock-in or “addiction”
Pooling: cap and trade
“[L]owering cost does not increase incentives for valuable innovation . . . [there is] a tradeoff between short-term cost effectiveness and investment in . . . long-term economic and environmental progress.”

– Emissions trading expert David Driesen, Syracuse Law School, 2008
Pooling: carbon offsets
HOW DO YOU PLAN TO MAKE A LIVING?

I'VE SET UP A WEBSITE WHERE PEOPLE CAN BUY MY CARBON CREDITS!

THEY CAN TAKE AIRPLANES AND DRIVE SUVs, THEN JUST PAY ME TO STAY IN BED!
Reduction
CONSEQUENCES
Accumulation of useless or “toxic” assets.
CARBON OFFSETTING DOES NOT WORK
“Offsets are an imaginary commodity created by deducting what you hope happens from what you guess would have happened.”

Dan Welch, Ethical Corporation
“I guess in some ways it’s akin to subprime . . . You keep layering on crap until you say, ‘We can’t do this anymore.’”

Marc Stuart,
EcoSecurities,
in the wake of the firm’s stock crash in spring 2008
“The European Emissions Trading Scheme has done nothing to curb emissions . . . is a highly regressive tax falling mostly on poor people . . . Enhances the market power of generators. Have policy goals been achieved? Prices up, emissions up, profits up . . . so, not really.”

*Peter Atherton, Citigroup Global Markets, January 2007*

“All generation-based utilities – **winners**. Coal and nuclear-based generators – **biggest winners**. Hedge funds and energy traders – **even bigger winners**. **Losers** . . . herm . . . Consumers!”

EFFECTS ON THE POOR
Financial Derivatives

“The ascension of circulatory capital generates a double movement in which new forms of financial progress and freedom, as defined by the West, are inseparable from the rise of anew form of domination and disenfranchisement, generally and most visibly visited on others.”

Edward LiPuma and Benjamin Lee, *Financial Derivatives and the Globalization of Risk*

“The biggest loss of assets by African-Americans in US history …. Puts some of society’s most vulnerable citizens at risk … enables questionable infrastructure projects … rises in food prices … ”

Nicholas Hildyard, *A (Crumbling) Wall of Money*
Carbon Trading

No Carbon Market for FOREST

World Bank GET YOUR **A** OUT FROM OUR FORESTS.
“Our people are sick and dying from the refineries. Trading schemes knowingly concentrate pollution, exacerbating existing ‘hot spots’ in our communities of color. You can’t buy us off with promises of parks and asthma education programs, and then somehow think we’ll be OK with subjecting our children to increased cancer risk.”

Dr. Henry Clark,
West County Toxics Coalition
“. . . If the Public Utilities Commission’s proposed decision [to back cap and trade] is implemented it could very well harm low income residents, make fewer funds available for energy efficiency investments and renewables, and undermine Los Angeles’ ability to reach its goals.”

State Senator Alex Padilla,
letter to Commissioner Timothy Simon, PUC,
19 February 2008
“As a long time worker and activist for renewables in Africa, I have been thoroughly discouraged with eco-entrepreneurs looking for the next green carbon offset opportunity in Africa. We seem to forget that originally, it was about rural livelihoods, creating wealth and renewable energy. When the company for which I worked for 10 years got into carbon trading, I became increasingly distraught. **It was no longer about ‘sustainable development’, it was about tonnes of CO₂ on make-believe spread sheets. Donor agencies are throwing money at carbon trading like nobody's business.**”

Renewable energy worker, East Africa
THE TROUBLE WITH REGULATION*

*when the object of regulation is unregulatable
What can we learn from the attempt to “regulate” the CDM market?

Unverifiability → credibility challenges → demand for regulation → increasing bureaucracy, complexity, mathematization

Market/regulation becomes skewed further in favor of big actors capable of deploying technical expertise → reinforcement of the fossil fuel economy at the expense of fruitful initiatives

Corporations and market ideologues resist, seeking easier credits → flooding of market with “nonsense credits” at the expense of fruitful initiatives → reinforcement of the fossil fuel economy
- Rhodia (France) makes adipic acid in South Korea.
- Invests $15 million in equipment that destroys nitrous oxide.
- Nitrous oxide is a greenhouse gas said to be 310 times more potent than carbon dioxide, so Rhodia can generate 310 tons of carbon credits just by burning one tonne of the compound.
- Thus enabling production of $1 billion in UN-approved carbon credits for sale to polluting industries in industrialized countries.

**Does the trade reduce overall greenhouse gases?**
-- No. Customers buy Rhodia’s credits only so that they can continue to invest in fossil fuels.

**Does the trade help Korea decarbonize?**
-- No. At best, it’s irrelevant; at worst, it encourages the country to build more dirty industries so that it can make money cleaning up later. Rhodia already makes 35 times more money selling carbon credits than it does from the adipic acid market.

**Does the deal promote green innovation?**
-- No, the technology Rhodia uses dates from the 1970s.
# Who benefits?

## Buyers

- Shell
- BHP-Billiton
- EDF
- RWE
- Endesa
- Rhodia Energy
- Mitsubishi
- Cargill
- Nippon Steel
- ABN Amro
- Chevron
- Chugoku Electric Power

## Sellers

- Tata Chemicals
- ITC
- Plantar
- Votorantim
- Petrobras
- Shri Bajrang
- Birla
- Oil & Gas Nat. Corp.
- Sasol
- Mondi
- Hu-Chems Fine Chemical
- Chhatisgarh Electricity Co.
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2020 (proj.) 4.067b 5390
More lessons …

Massive growth in speculation

Globalization

Belief in “market governance”

Increasing complexity and mathematization, unsoundly based

Regulatory capability is swamped, or, insofar as it is attempted, is *de facto* passed to private ratings agencies and interested officials from the “derivatives world” and “carbon trading world”

Regulatory capture
“Beginning in the 1970s, regulators had given up trying to keep pace with modern financial markets. Instead of making substantive decisions about which securities financial institutions should be permitted to buy and sell, the regulators had deferred to the credit-rating agencies, by passing rules and regulations that depended on ratings . . . [credit-rating agencies’] business boomed. Moody's became a free-standing, publicly traded company worth more than $5 billion … the credit-rating agencies' inaccurate ratings of corporate debt and the tranches of collateralized debt obligations … made the parts worth more than the whole . . . CDOs … made sense only because of foolish credit ratings and the legal rules that depended on them …supposedly sophisticated financial experts … had been unable to assess the risk and value of their own investments in derivatives: Bankers Trust, Salomon Brothers, … Barings, Kidder Peabody, Enron, and so on. …”

Frank Partnoy, UCLA
Is “people’s participation in preventing corruption” possible in the carbon markets?
“What used to be a conflict [of interest] is now a synergy.”

Jack Grubman,
Salomon Smith Barney,
2000
Carbon Trading

There is a “clear and perceived risk of collusion” between the private sector carbon auditors approved by the UN and the companies that hire them to review their offset schemes, due to their strong interest in gaining future contracts.

Head, UN CDM Executive Board

Between the start of the market and the end of 2006, auditors passed over 92 per cent of the South-based projects that were proposed to them. In 2006, the UN’s Clean Development Mechanism Board approved 96 per cent of the projects proposed to it and 91 per cent in 2007.

Wall Street Journal
Nicholas Stern

Author, UK government Stern Report backing expanded carbon trade.

Vice-Chair, IDEACarbon.

Set up carbon credit ratings agency with client base of credit sellers.
Lex de Jonge

Head of carbon offset purchase programme, The Netherlands.

Vice-chair, CDM Executive Board (UN offset regulator).
Christoph Sutter

Member, UN CDM Methodology Panel.

CEO, South Pole Carbon Asset Management.
Agus Sari

Head, Indonesian office, EcoSecurities.

Special adviser to the president of the 2007 UN climate negotiations.
Harald Dovland

Senior adviser, Econ Pöyry.

Chair, Ad Hoc Working Group, UN climate conference, April 2008.
UK All-Parliamentary Climate Change Group.

Secretariat provided by
Rivolving doors . . .

Ken Newcombe

Former head, World Bank Prototype Carbon Fund.

Moved to Climate Change Capital.

Now head of US carbon trading desk, Goldman Sachs.
Henry Derwent

Former Director, International Climate Change, UK Department for Environment, Food and Rural Affairs.

LESSONS FOR THE FUTURE
The civics-class formula “no matter what the system, it will always be possible to regulate it” is not an axiom for effective anti-corruption activism in the real world. Where practicable forms of governance entail or encourage corruption, and in an environment of “market governance” in which the concept of conflict of interest has eroded, reflexive calls for “more and better regulation” may not be constructive. More nuanced, varied and practical approaches are needed.
In particular, there is a need to keep up with the times by paying careful attention to the political implications of new forms of commodification and trading instrument, together with their technical opacity, unverifiability, global scope and divergence from underlying values.

Combating “corruption” in contemporary climate politics cannot shirk inquiry into such values – in particular, discussion of what a valid climate solution would look like, what it might require in terms of “backcasting”, and possible supporting contexts of public investment, regulation, and support for local initiatives and grassroots movement-building.
For more information

http://www.thecornerhouse.org.uk/subject/climate
http://www.carbontradewatch.org/
http://www.sinkswatch.org
http://www.ejmatters.org
http://www.wrm.org.uy
http://www.risingtidenorthamerica.org
http://www.ipocafrica.org

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http://www.thecornerhouse.org.uk/subject/climate