CHANDRAN NAIR

# Betting on Market-Driven Solutions

**The global public good should not be placed on the sacrificial altar of the private interests of unregulated financiers. Governments, not solely the market, should be involved in alternative energy industries.**

How to expand the global economy without depleting the planet's resources is a challenge that has been ignored for far too long. The financial meltdown has now come as a stark reminder of the grave consequences of the world's failure to strive for sustainable development.

Humanity faces an urgent challenge: climate change, largely brought about by human activity and excess. As few as five years ago, many governments, politicians, and corporations were in denial, refusing to accept the limits to unsustainable practices. The financial world relied on market mechanisms for righting breakdowns, even those affecting the natural world.

The origins of the financial crisis—subprime mortgages—tell the story of unsustainable ways. Those in the United States who procured subprime loans were not destitute, homeless individuals. According to the Durham, North Carolina–based Center for Responsible Lending, 90 percent of the people who obtained subprime loans from 1998 to 2006 already owned homes and, according to world averages, probably belonged to the top 10 percent of the population in terms of quality of life and housing.

Many people refinanced homes, further fueling a consumption-driven lifestyle—in some cases to make ends meet, but in others, to purchase second homes and other extravagances. With banks miraculously financing these excesses, many spent beyond their means. Second homes not only tax the planet's resources, but their heating and cooling needs also gobble up energy.

Consumers are not the only offenders. Lured by the promise of disproportionate rewards, banks fed this culture of "more and bigger is better," overlooking how high-risk loans would be repaid. Banks lent to unqualified borrowers, ultimately leading to plummeting property prices, a slowdown in the U.S. economy, and trillions of dollars in bank losses, and wiping out the savings of millions of people around the world.

With climate change, the parallels are evident: mankind heads toward disaster while many people hold on to the belief that the markets will save the day. Much of this philosophy is pushed by the Anglo-Saxon centers of finance in London and New York City. Many policy makers pin hopes on market-driven solutions—in the form of carbon credits or bets on investments in renewables—to solve the climate crisis. The reality, however, is that market mechanisms have serious limitations and carry the potential to create more problems than solutions.

A closer look at carbon trading shows rampant problems with this proposed panacea. First, carbon trading does not reduce emissions, but rather frees polluters of responsibility by allowing them to purchase credits elsewhere—typically in developing countries—thus encouraging complacency.

Carbon trading also is unreliable, and the tools to measure credits are imprecise. Trading companies disagree on the level of credits required for the simplest offset calculations. Companies tend to favor a quick fix by investing in cheap, short-term projects. The remedy demands sacrifices of people in the developing world who are already scratching out a miserable living; even in booming China, almost half the population still struggles on an income of $2 or less per day. With political survival at stake, no government, democratic or otherwise, will adopt complex global trading schemes run by Western banks and risk dashing the economic aspirations of their people.

Renewable energy schemes also are vulnerable to excesses. As the stakes rise and project proponents become greedier, bankers and lawyers develop increasingly complex, opaque financial instruments to tap into growing potential—as is already happening in the emissions trading markets. The results will be high, short-term profits for the usual suspects of investment banks, fund managers, analysts, and speculators with little regard for reversing negative trends. This distorts the focus, shifting it from crisis mitigation to profit generation. Reckless behavior will not be self-corrected by the competitive market until it is much too late.

Problems associated with overdependence on market solutions to address climate issues are already apparent. In the past few months, investments in renewable energy resources have dried up—a decline triggered by the financial crisis and decisions by bankers driven by short-term profit motives and lacking understanding of the renewables industry. Even in areas that have remained strong throughout the downturn—namely early-stage venture capital investments in developing clean-energy technologies and building new capacity, such as wind farms or solar parks—project proponents depend on funding from the same

**CHANDRAN NAIR** is founder and CEO of Hong Kong's nonprofit think tank Global Institute for Tomorrow.

institutions that brought down Wall Street through their preoccupation with maximizing profit.

Natural checks on rampant consumption-driven growth exist, but the market, corrupted by perverse incentives and over-consumption, has ignored the warning signals. Those who hold the belief that there should be no limits on the market are living in a fantasy world, and one can hope that steadfast belief in market mechanisms is beginning to lose credibility. With global markets on shaky ground, governments have intervened to ensure stability.

The same should be the case for climate issues. The global public good should not be placed on the sacrificial altar of the private interests of unregulated financiers. In the case of climate change, clean-technology projects need funding, and that funding should come from the public purse, not solely through financial instruments designed to create disproportionate profits for the few who control capital flows.

Better strategies must be found to combat climate change, but the most obvious strategy is also the least popular. Reducing emissions requires rapid reduction in the consumption of fossil fuels, and that means accepting limits to growth based on promoting relentless consumption.

A close look at the unfettered ecological consumption patterns of countries shows that economic growth pursued under free-market conditions allows the same type of excesses that caused the financial crisis. Population and consumption patterns of three ecological-debtor countries are particularly telling: the United States consumes 1.8 times its national biocapacity—the area available to produce resources and capture emissions; China consumes 2.3 times its biocapacity and India, 2.2 times. The global average *available* biocapacity per person is 5.2 acres (2.1 ha) per person, but the global average *actual* per-person footprint is as high as 6.7 acres (2.7 ha). Americans require 23.2 global acres (9.4 ha) on average, while residents of poorer countries require only one to two acres (0.4 to 0.8 ha).

Until far-reaching regulations are introduced to reduce emissions, the true innovations needed to protect humanity will not surface. Draconian measures to make sustainability operable are a key element because few people act purely for the greater good. Awareness and pious words do not constitute action.

Such measures, of course, are easier to enforce under authoritarian forms of government than in liberal democracies. China, for example, managed to reduce pollution levels in Beijing by imposing restrictions on car use on certain days of the week. Public acceptance in China of this policy promoting the greater good illustrates that effective solutions to the climate crisis depend on taking actions free of political intervention by vested interests.

The financial crisis demonstrated the need for strong government to protect the public good. In a resource-constrained world, likewise, there is no substitute for sound regulations. Policy makers must concede that capitalism has met its nemesis in climate change and should not be seduced by the market's promise of a quick fix. UL

*See "Talking Global Sustainability with Chandran Nair" by Ron Nyren, July 2007, page 30.*