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## ECONOMIC NEWS UPDATE

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### **How Green is My Offset?**

Food-price inflation so severe that central banks are forced to raise interest rates to growth-stifling levels; corn prices so high that poor Mexicans can't afford their tortillas; massive deforestation to make way for more corn and palm oil; poor farmers pushed off their land to make room for carbon-offsetting plantings paid for by rich jet-setters; forests that trap more heat than they help to get rid of; and Al Gore for president.

These are some of the unpleasant, unintended consequences of hastily conceived environmental policies. In America, President Bush has decided that we can plant our way out of dependence on foreign oil. He envisages a future in which America's fuel will come from planting above ground rather than drilling below it. In Europe, Angela Merkel and Tony Blair have hit upon carbon trading as the solution to global warming, and the man whose mirror assures him that he is the

greenest of them all, David Cameron, is putting a windmill on his roof to generate enough electricity to power his hair dryer.

None of these riders on the environmental bandwagon -- powered no doubt by biofuels -- worries very much about the cost of these policies, or have given the slightest consideration to the only consequences that are certain - - the unintended consequences, some of which I have listed above. And Al Gore, the former Vice President turned Academy-Award winning movie producer (and waiting in the wings to enter the race for the Democratic nomination for president), says our choices are action this day, or desertization and flooding will be upon us very soon.

Speaking of the Academy Awards, the stars, starlets and wannabes participating in this exercise in self-adulation poured into the hall from their limousines and private jets,

but assured us that the entire flood-lit affair was carbon neutral. It seems that they had purchased what are known as “carbon offsets”, a system by which they pay others to curtail carbon emissions, or fund renewable energy sources. These deals, which are running at an annual rate of about \$100 million per year and rising according to Business Week, “have become one of the most widely promoted products marketed to checkbook environmentalists.”

Small problem. The offsets purchased by the Academy of Motion Picture Arts & Sciences were purchased from TerraPass Inc., a firm with a portfolio of offset projects that include a garbage dump in Arkansas, managed by Waste Management Inc. TerraPass has purchased thousands of tons of gas reductions resulting from Waste Management’s decision to burn off the methane produced by the decomposing trash. But the company’s managers and state regulators told Business Week that the decision to burn off the methane had “nothing to do with TerraPass’ efforts”. Or with the offsets purchased by the Hollywood greens.

There are more such stories, but you get the idea: the reductions in greenhouse gas emissions claimed by those intent on being green without changing their lifestyles are very often bogus -- they would have happened without the purchase of offsets.

That is the least of the problems created by the new environmental panic. The rainforests of Indonesia and Malaysia are being decimated in the rush to increase the production of palm oil, used as a biofuel. And in many countries poor farmers are having their land confiscated so that rich consumers can plant trees to lighten their carbon

footprints.

Farmers are also cashing in on the huge subsidies made available to them by the government’s decision to subsidize ethanol and biodiesel production from corn, sugar, and other crops in addition to palm oil. Ethanol from corn is a particular favorite of all the presidential candidates vying for votes in corn-growing Iowa, with the honorable exception of John McCain, who knows a boondoggle when he sees one. Direct subsidies paid to ethanol producers are heading towards \$8.7 billion annually, or about \$1.25 per gallon for a fuel that would otherwise be too costly to interest consumers. Good news for producers of the corn the ethanol producers need, and for sugar farmers similarly situated. Prices are up, and so are land values.

The result is a problem for central banks. In the past, spikes in food prices have been seen as temporary, usually weather-related, requiring no reaction from the inflation-watchers. But this jump is different, perhaps a plateau rather than a spike: chickens and cattle are more expensive to feed, driving up the price of eggs and beef and dairy products, and soft drink prices are under pressure from rising sugar costs. This food inflation is felt most keenly in poorer countries, where food costs make up a larger part of the average budget than they do in the developed world. But even in the richest countries, central bankers are wondering whether they will have to raise interest rates to cool growth sufficiently to offset the effects of rising food prices.

None of this means policymakers should avoid confronting the possibility that the earth is warming, and the further possibility that the cause is

human consumption of fossil fuels. We can't be certain, despite Al Gore's movie and the heated press releases that often accompany more balanced scientific reports. But there is enough evidence to warrant sensible steps to reduce carbon emissions.

But think before you legislate. The EU introduced an emissions trading scheme that California intends to copy -- and watched greenhouse gas emissions rise by 30 million tons, or about 1.5%, because too many permits were issued. Europe's four biggest power producers pocketed €8 billion (about \$10 billion) from the sale of their excess permits, and UK generators an estimated £1 billion (about \$2 billion). That doesn't mean such trading schemes are inherently flawed, but it does suggest that haste makes more than a little waste.

Cap-and-trade, properly done, and carbon taxes, properly levied, should be explored as ways of getting the costs of pollution reflected in the prices consumers pay. That would provide an incentive to entrepreneurs to come up with efficient alternatives to fossil fuel consumption, and relieve governments of attempting to pick winners. There are efficient ways to cut emissions, but politicians grabbing for headlines are not going to be the ones to discover them.



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