Business Times - 12 Nov 2002

Archived Hock Lock

Investors go green with tradable carbon rights

By
Anthony Rowley

WORRIED about the ethical issues of your investments? Well, there is a more socially responsible investment you may want to consider. It is tradable 'carbon rights', which could prove to be one of the most rapidly expanding asset classes of the future.

For South-east Asian investors in particular, buying carbon rights based on regional forestry resources could be an ideal investment in preserving the region's environment - and a chance to make a profit in the process.

Early stages: There is no point in rushing out to buy just yet, as the market is still in its earliest stages of development and it is very much an institutional investor play, just like many other so-called 'alternative asset' classes.

But experts envision the growth of a market running into possibly hundreds of billion of dollars, where tradable carbon rights could be securitized and packaged for retail investors. Insurance companies and pension fund investments in these instruments could also offer indirect access.

Put simply, tradable carbon rights are claims on carbon-conserving or 'carbon-sequestering' assets such as forests. The potential buyers are industrial companies which, in order to meet their environmental obligations under the Kyoto Protocol - or other international regimes to control greenhouse gases - could trade a purchase of carbon assets in one part of the world for the right to continue polluting in another.

That is not as environmentally bad as it sounds because the whole exercise is meant to balance out, with carbon 'sinks' - such as forests - helping to absorb pollution on a global basis.

Since it is clearly difficult for buyers in, say, the US, Europe or Japan to find sellers of such rights in Asia, Latin America or Africa, there is obvious scope for a major trading market to develop, where primary transactions among corporate players and, say, farmers, can be converted into liquid secondary market activities. Once brokers, dealers and other market makers get involved, a whole range of investors can then come in, as they do in many other traditional commodity markets.

The potential of this fascinating, and as yet little-known, market came into clearer perspective last week when the so-called Katoomba Group held its fifth annual meeting at the United National University in Tokyo. The Katoomba Group was launched by Forest Trends, a body based in Washington DC which describes itself as a non-profit organization created by leaders from conservation organizations, forest product firms, research groups, multilateral development banks, private investment funds and foundations.

The Katoomba Group itself (named after an aboriginal site near Sydney) brings together representatives of forestry and finance companies, environmental policy and research organizations, governmental agencies, as well as business and non-profit groups.

It enables former 'enemies' such as conservationists and multinational corporations to find common ground, as Minoru Makihara, chairman of Mitsubishi Corporation, remarked at the meeting. (Japan has often been the subject of forest conservationists' ire for its logging activities in South-east Asia and elsewhere.)

If conservation is to take firm hold among world business leaders and investors, it is essential to 'give value' to forests and other parts of the environment, suggested Mr Makihara. Up to now, forests - especially so-called 'old growth' forests containing the most valuable hardwood logs and which are invaluable repositories of bio-diversity - have been more often plundered than preserved, not least in South-east Asia.

Mark Campanale of Henderson Investors recalled in the Tokyo meeting the great timber boom (and bust) of the early to mid-1990s when Malaysian and other timber companies made vast profits out of logging, before the 'meltdown' came. By listing their shares, they were able to leverage their operations, buying forests as far afield as the Solomon Islands or Africa in some cases.

Forests are 'still seen as areas of speculative gain' said Mr Campanale. Ken Newcombe, the World Bank's senior manager for carbon finance, suggested at the Tokyo meeting that a lot more "private dollars' from major corporations around the world need to be attracted into responsible forestry management.

Tradeable carbon rights could be one way of achieving this. To set the ball rolling, the World Bank launched a US$100 million Biocarbon Fund at the Tokyo meeting. This will help create a supply of tradable carbon rights in the developing world, which currently are in short supply relative to demand from industrialized countries in the run up to implementation of the Kyoto Protocol.

Apart from providing value sources of carbon to offset polluting emissions, forests have value for pharmaceutical and cosmetic producers, as well as tourism groups, that might be prepared to invest in securities that preserve forests.

Logging rights: But there are problems. Timber barons may prefer to lease out forests to loggers rather than get involved in trading carbon rights. Small holders may be more willing to do so - enabling them to preserve their resources - but land reform is not proceeding at a fast enough rate to suggest that they can swing the balance.

The answer seems to be to appeal to the venal instincts of forest owners so that selling carbon rights becomes as attractive as selling logging rights. This is where the new market comes in. The billions of dollars controlled by institutional investors around the globe suggests that it could be a potent one in time.