Investment bubbles and climate politics

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If you didn't read Matt Taibbi's piece "The Great American Bubble Machine" from *Rolling Stone*, then this is a good time to check it out. The article, which argues that the investment firm Goldman Sachs has been behind a series of disastrous speculative bubbles in recent years, has received a great deal of attention.

Why am I mentioning this piece on a climate blog?

Two reasons.

First, Taibbi charges that last year's oil price surge was an investment bubble rigged by Wall Street:

…the price of a single barrel went from around $60 in the middle of 2007 to a high of $147 in the summer of 2008.

That summer, as the presidential campaign heated up, the accepted explanation for why gasoline had hit $4.11 a gallon was that there was a problem with the world oil supply…

But it was all a lie. While the global supply of oil will eventually dry up, the short term flow has actually been increasing. In the six months before prices spiked, according to the U.S. Energy Information Administration, the world oil supply rose from 85.24 million barrels a day to 85.72 million. Over the same period, world oil demand dropped from 86.82 million barrels a day to 86.07 million. Not only was the short term supply of oil rising, the demand for it was falling — which, in classic economic terms, should have brought prices at the pump down.

So what caused the huge spike in oil prices? …the root cause had almost everything to do with the behavior of a few powerful actors determined to turn the once solid market into a speculative casino. Goldman did it by persuading pension funds and other large institutional investors to invest in oil futures — agreeing to buy oil at a certain price on a fixed date. The push transformed oil from a physical commodity, rigidly subject to supply and demand, into something to bet on, like a stock. Between 2003 and 2008, the amount of speculative money in commodities grew from $13 billion to $317 billion, an increase of 2,300 percent. By 2008, a barrel of oil was traded 27 times, on average, before it was actually delivered and consumed.

Environmentalists are often encouraged to make common cause with foreign policy hawks who want to reduce western reliance upon Middle Eastern oil. However, many of those hawks will lose interest in "energy independence" once oil prices settle into an affordable price range. Also, many of those hawks support development of Canadian tar sands and other energy sources that would reduce dependence upon OPEC, but not reduce greenhouse gas emissions.

The second reason Taibbi's article is relevant for readers of this blog is that he alleges that Wall Street is chomping at the bit to create a speculative bubble in climate-related securities:

If the bill passes, there will be limits for coal plants, utilities, natural-gas distributors and numerous other industries on the amount of carbon emissions (a.k.a. greenhouse gases) they can produce per year. If the companies go over their allotment, they will be able to buy "allocations" or credits from other companies that have managed to produce fewer emissions. President Obama conservatively estimates that about $646 billion worth of carbon credits will be auctioned in the first seven years; one of his top economic aides speculates that the real number might be twice or even three times that amount.

The feature of this plan that has special appeal to speculators is that the "cap" on carbon will be continually lowered by the government, which means that carbon credits will become more and more scarce with each passing year. Which means that this is a brand new commodities market where the main commodity to be traded is guaranteed to rise in price over time. The volume of this new market will be upwards of a trillion dollars annually; for comparison's sake, the annual combined revenues of all electricity suppliers in the U.S. total $320 billion…

Well, you might say, who cares? If cap-and-trade succeeds, won't we all be saved from the catastrophe of global warming? Maybe — but cap-and-trade, as envisioned by Goldman, is really just a carbon tax structured so that private interests collect the revenues. Instead of simply imposing a fixed government levy on carbon pollution and forcing unclean energy producers to pay for the mess they make, cap-and-trade will allow a small tribe of greedy-as-hell Wall Street swine to turn yet another commodities market into a private tax-collection scheme.

Under a carbon tax, governments could use revenues to make other green investments. Also, taxes are more transparent, less vulnerable to manipulation by speculators, and readily calibrated to provide rebates for the poorest consumers. Cap-and-trade would be a market mechanism for reducing emissions that would likely be superior to the status quo, but the scheme is almost surely not the best policy option.

Last week, incidentally, Dean Starkman provided a nice overview of the controversy about Taibbi's piece in the *Columbia Journalism Review*. Check it out

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