

Alternative Energy: Talking up carbon

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As the International Energy Agency (IEA) launched its World Energy Outlook report, it called for a doubling of the price of carbon credits to tackle climate change.

Governments and markets don't mix

There are some fundamental problems to doubling the price of carbon credits – not least the fact that the cap-and-trade energy bill, now under consideration in the US Senate, includes limits to prevent the price of carbon emissions permits rising above \$28 per tonne in 2012. This limit rises to about \$48 in 2020 and about \$90 in 2030. The IEA's demands would test these limits. With a 13% acceptance rating on opengov.org, even this bill will require a huge effort to pass.

Political expediency

In almost any market there is a political expediency to suppress prices. Whilst this might get politicians elected and re-elected it plays havoc with the market. The Florida homeowners insurance market is constantly driven by political pressure to keep prices down. This market is connected to the carbon issue if you believe that global warming is increasing the frequency and/or intensity of hurricanes.

In a similar vein, the IEA is predicting that, on the current carbon emissions path, future emissions will have to be far more radically slashed in order to prevent global warming. The IEA believes that meeting the 450ppm target for carbon concentration in the atmosphere is crucial to the campaign to prevent global warming.

Facts are, if you own a house on stilts facing the Atlantic in Key Biscane, Florida then there is a severe risk to it from hurricanes and insuring that risk is expensive. The State Government can suppress that price for a while, but at the end of the day the price is the price and if it is suppressed for a while, then it has to spike for a while to average out.

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A good friend of the BRAVE partners lives in Key Biscane, but as he runs a homeowners insurance company, he knows the cost of hurricane damage.

Carbon bounce

The Financial Times has been one of the few news media organizations following this story closely. It reports:

“As Fatih Birol, the IEA's chief economist, put it to the FT, two numbers will shape the future of the world's energy supplies: 450 and 147.

450 parts per million is the maximum concentration of greenhouse gases in the atmosphere compatible with giving the world a 50/50 chance of keeping the global temperature increase below 2°C: the level agreed by leading economies' governments as the acceptable limit for climate change.

\$147 is the price that oil reached at its peak in July last year: a level that the IEA believes played an important role in triggering the world recession.

Those two numbers set out the dimensions of the challenge the world faces.”

The cost of low carbon prices

Governments may keep carbon prices low today, but that will hamper the development of true alternatives to fossil fuels. Moreover, this might just be window dressing. In order to meet the 450ppm target, the world's energy infrastructure has to be radically different. As the FT comments:

“A world reshaped to hit that 450ppm target would be very different from today. By 2030, about 60 per cent of all new cars sold would have to have some form of battery power, whether hybrid or all-electric. That electricity would have to be produced with much lower emissions, and by 2030, about a third of the world's total energy supplies would have to come from zero-carbon sources such as nuclear and renewables.”

Financial Times

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These developments all need funding and in the absence of efficient carbon markets this funding will come from government subsidies – or to put it another way: TAX.

Let the markets work

BRAVE Partners recently gave a breakfast briefing at the Institute of Energy. One of the questions afterwards was on what BRAVE Partners would suggest needs to be done to improve financing and development of alternative and renewable energy. BRAVE partner, Christopher Cloke-Browne's response was that governments should establish robust, stable and free markets for carbon trading. This would allow projects to fund themselves by forward selling carbon credits.

In the current environment there is huge uncertainty over the future prices of carbon credits, especially beyond 2012 where the Kyoto pact runs out. The uncertainty over America's engagement, and on what terms, together with the recent decision by the parliament in Australia to reject a carbon trading scheme creates a huge void in the market. Carbon credits do not trade forward efficiently and really do not trade at all beyond 2012.

In an interesting move, shortly after the Australian government rejected a carbon trading framework, the Head of ExxonMobil Australia announced that his company would favour a carbon tax. He cited that the market as too uncertain and subject to sudden peaks and troughs.

Tax versus trade

In what would appear to be an "ExxonMobil hugs a hoody" event, Friends of the Earth has announced that it supports a carbon tax rather than a carbon trading scheme. Friends of the Earth also sighted uncertainty and instability of carbon prices – in particular the organization said that the market price for carbon is too low.

Efficient markets

BRAVE Partners believes that the fact that ExxonMobil and Friends of the Earth (seeming to be two opposing sides of the debate) both favour a tax bears out the weakness in this system. BRAVE Partners believes that because both of them have powerful lobbying machines, they believe that their organisation can influence the rate of that tax. Tax is ultimately a government tool and thereby highly politically driven.

Inefficient markets favour traders - efficient markets favour the economy.

The current inefficiencies in the market are driven by uncertainty over government actions. If carbon pricing is too low or too high, or just too plain damn uncertain – then it is down to artificial caps and floors inserted in government legislation and uncertainty over the amount of global carbon emissions

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that will be priced. What is the carbon price where the largest emitter of CO₂ in the world does not charge for it?

The 70's man

The whole concept of carbon trading was developed in the United States from work carried out in the 1960s and completed in 1970.

BRAVE Partners believes that there are a number of viable technologies emerging that will improve energy efficiency and replace fossil fuels. These technologies need a stable carbon market to flourish. It is time the government stopped trying to help and started building the environment needed for these technologies to flourish.

About BRAVE Partners

BRAVE Partners seeks to use their strong engineering skills and background to promote energy and insurance businesses that have a unique, compelling business case. The firm seeks to root out the real issues with a proposal and ensure that the business management has addressed them.

- *The IEA wants the price of carbon to rise.*
- *BRAVE Partners says – free the markets and let them decide the price of carbon.*
- *BRAVE Partners can advise renewable energy business on their approach to realising the value of their carbon credits.*

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