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We Can Do Better on Energy & Environmental Policy

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There is a definite lack of long-term vision on energy and environmental policy which reflects a myopic view of how the world works. Politicians are timid. They don't level with their constituents that the road to a greener and cleaner world will cost them more money. We are fed platitudes. We are told that this shortfall will all come out in the wash, magically, or by appropriations or a “carbon tax.” There is no “free lunch.” It is going to cost American consumers more in everything they do and everything they buy because de-carbonization of the U.S. economy will cost big money. Waving a magic wand will not catapult us into the Promised Land.

Rising healthcare costs are, for example, directly related to environmental degradation. How? I am pleased to say that I helped get the lead out of gasoline over 30 years ago and that benefited the health of society at large and children, in particular. Getting the lead out presented a cost to the oil industry and that cost was passed on to consumers whenever they purchased gasoline. While industry initially balked, it eventually complied and got the job done. With carbon, the costs of implementation are going to be even more onerous. However, the benefits are going to be unquestionably positive.

In order to enjoy these benefits, we will experience higher costs in electricity bills, automobile purchases, air travel, cost of maintaining cleaner buildings through green retrofits, and so on. That is why "economy-wide" means national and long-term. This also means committing to major league investment in infrastructure. The benefits for a sustainable, functioning society are paramount. Blackouts cost the economy money. Air travel delays cost the economy money. Sick building cost workers their health, resulting in sick days or worse and their business employers lose revenue and productivity. The list is almost endless. The loss of productivity has not been quantified adequately.

Why Cap and Trade Will Work

There is a misconception in policy circles in both Washington, D.C. and at the state level that carbon trading was invented in Europe and that we need to learn from the Europeans. The reality is that it was invented on Wall Street! We took a financial instrument called mortgage-backed securities and applied it to air quality. It worked for acid rain and urban ozone remediation and continues to this very day. The acid rain program expires in 2035, and there is a financial market going that long-term. The same kind of public policies are now beginning to emerge in carbon markets. But politicians and bureaucrats are making strange noises about not letting financial institutions such as investment banks and hedge funds into the market. And what if, heaven forbid, they make a profit doing it! Excuse me, but that is what brings liquidity to markets, and isn't that what capitalism is all about? We need the participation of financial players and cannot be afraid of so-called market manipulation. We are still hearing echoes of the Enron effect in policy circles, especially in gun-shy California where I was recently visiting. You may know I wrote the first best-seller on Enron. Enron did not make the carbon market or cap and trade markets. They simply participated, like many others. It's political cover, but poor public policy.

Transparency in serializing carbon on the US EPA website and state registries will not allow that kind of market manipulation. The need is for government to engage the financial markets, not be afraid of them. After all, where is the capital going to come from for cleaner investment in plant and equipment if not from the private sector?

The New Metrics of Cap and Trade

We now come to the juncture of how we design a properly functioning long-tem carbon market. That means creating a long-term clearly defined policy framework with significant cuts. 25 percent reduction by 2020 is attainable and 80 percent by 2050 will set the bar high. If we are going to unleash the power of market innovation and capital, we need to set the bar that high. Saying we can't do it, means we don't get the job done. The benefits of reducing greenhouse gases are tantamount. Utilize the problem-solving skill set of engineers. They will get the job done. They understand thermodynamics, loop flow, and reducing emissions.

The second part of this equation is no price caps. We don't need a safety valve, as has been floated vociferously in Washington, D.C. policy circles. Price caps distort markets. We need to let the market set the price, and if that price is high, that economic pain will incent business to invest faster in cleaner technology.

The third factor is economy-wide upstream, not micromanaged, markets at the downstream or consumer level. That means significant cuts in emissions at utilities, energy and chemical companies, automobile and air transport, industry, and buildings, (which are incidentally a large piece of the greenhouse gas reduction puzzle).

The most important factor, not even mentioned in any carbon discussion in California, RGGI or the federal level except in the Lieberman bill, is the price for noncompliance. Under the European Union Emissions Trading Scheme (ETS) that price is 100 euro per ton. In the U.S.'s acid rain program that cost is $2300 per ton. It has led to almost 100 percent compliance in that program since 1995. This determination needs to be made and needs to be transparent. $200 per ton as proposed in the Lieberman bill is a good starting point. Industry fears economic sanctions, so give them some teeth.

Finally, how do we link the U.S. Federal program to state programs and international programs? This is not trivial. Only the U.S. Senate can confirm treaties and treaties are what is needed on climate change. The work needs to move forward to create common standards with both state level and international programs.

The goal of all these actions is the development of a regulatory policy framework that is long-term, transparent, economy-wide, and significant. The capital is ready to be deployed from the private sector, but it won't be deployed unless regulatory certainty can provide financial certainty for investment. Getting the rules right is an important job. We can get it done if we set the bar high and do not cater to every vested interest. Isn't that what the 2008 presidential campaign is all about—change for the future versus business as usual? We live in unusual times. We can do it if we aim high!

Peter C. Fusaro has been an active proponent of carbon mandates for almost 20 years. He sees the opening for action now. He holds the annual Wall Street Green Trading Summit in New York on April 2nd and 3rd with a pre-conference seminar on carbon trading and finance on April 1st (www.wsgts.com).