Reframing Cap and Trade

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By Peter Fusaro, Founder, Wall Street Green Trading Summit

Cap and Trade has been hijacked, the wind taken out of its sails by climate change skeptics. More specifically, the issue of market-based solutions for addressing environmental problems has been utterly distorted. The truth of the matter is that markets have worked to drive efficient, environmental results.

One of the prime examples of this is the acid rain problem. In the US Northeast, it has been remediated in a cost effective way using environmental financial markets since 1995. The urban ozone (smog) problem has been lessened in 22 states due to the use of markets to reduce nitrous oxide (NOX) emissions since 1999. In fact, in the US today, there are 38 environmental financial markets that remediate environmental problems for air quality and water quality and protect endangered species.

What this means is that it's time for the issue of cap and trade to be reframed. My argument is that environmental trading is only the **facilitator** to the implementation of cleaner technology and renewable energy. Cap and trade facilitates scaling of cleaner technologies by generating needed capital. And it has proven to be cost effective and adopted by industry with little violation of the law due to financial sanctions.

The point is that with clearly written environmental goals, industry has no choice but to innovate, invest and change behavior to meet those goals. That does not mean that the government dictates the kinds of technologies industry must adopt, it allows industry to solve its problems by choosing its own means. The polluters will determine how we get to a cleaner environment because they will be required to make their own decisions about how they invest in cleaner technologies, renewable energy and energy efficiency. This is the behavioral change that is needed to reduce emissions.

That brings us to the most important issue that has lacked any sort of momentum to date—the need for a price for carbon for the reduction of greenhouse gases.

Pricing Carbon

Without a material price, such as $30 to $50 per ton, which most analysts who run economic models agree is the real cost for carbon reductions, we don't get the impacts of reduced greenhouse gas emissions. We cannot reach this price per ton using only voluntary markets. Like anything else, the availability and adoption of clean and low carbon technologies are dependent on market demand. A price on carbon creates demand for regulation and compliance driven solutions, in this case cleaner technologies and renewable energy. This in turn demonstrates to investors that it's worth committing dollars during the risky early development stages of these companies because there will be buyers when the technology comes to market.

Today the price of carbon is $2.07 per ton in the Northeast under the Regional Greenhouse Gas Initiative, 10 cents on the Chicago Climate Exchange and $4 to $7 under the Climate Reserve in California. Unfortunately, none of these prices is incentivizing the private sector to do much about reducing greenhouse gases. A compliance mandate is needed to end the price disparity and volatility that exists in the voluntary markets. The real price of carbon is also higher than these markets reflect. A higher and more stable price for carbon is key to spurring significant activity in environmental markets. Also, with this price lacking or in the cases when a price has been set but has remained inaccurately low, potentially game changing technological options become eliminated based on cost alone.

Essentially, we're talking about an industry that needs $3 trillion to get off the ground. To achieve this what's really needed are hundreds of billions of dollars from the private sector, not the small amounts of money presently deployed. Today, government is the provider of last resort monies for early stage cleantech capital due to the credit crisis, with the stimulus contributing about $40 billion. Venture invested about $5.6 billion in 2009, and large private institutions aren't even in the game yet. When all the stimulus monies are dissipated, we will need private sector dollars in the hundreds of billions not only to pick-up where federal funds left-off, but to scale cleaner technologies.

Aligning Policy and Market Forces

So, where do we go from here? It seems unlikely that this session of Congress can pass meaningful and binding legislation to start to reduce the US carbon footprint, and regroup for next year's session. The way forward now is voluntary markets, which are small and smaller compliance markets in the Northeast and California. These markets were $2.75 billion in 2009 compared to a global carbon market of $136 billion. The US carbon footprint is 6.1 billion metric tons, second to China, and we are barely doing anything material to make greenhouse gas reductions.

The need is clear, and it is now time to educate the public that cap and trade works for environmental remediation. This has clearly been the case with the reduction of sulfur dioxide emissions under the Acid Rain program, and equally true of nitrous oxide (urban smog) reductions during the past two decades. It is going to cost money to clean up this problem, which is another issue that politicians don't like to talk about. Creating the green economy

requires time, money, technology, education and government regulation. That is not a bad thing if you consider the benefits of higher paying green jobs that don't exist today. A price for carbon *is* the game changer!

Peter Fusaro is the founder of of the **Wall Street Green Trading Summit**. In its 9th year, it will take place on March 23-24, 2010 in New York City.

Peter is also the best selling author of *What Went Wrong at Enron* and is an energy industry thought leader noted for his keen insights in emerging energy and environmental markets. He co-founded the **Energy Hedge Fund Center** in 2004, as well as **Global Change Associates** in 1991, the latter which to focus on the interplay and convergence of energy and environmental financial markets.