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The Shape of Green Things to Come in 2009

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It's the end of another year, an appropriate time for a forward look at energy and environmental issues. Many ideas are buzzing around Washington D.C. policy circles now. What policies will be implemented, when will they be implemented and how will they be implemented? These are important questions.

The billions of Federal dollars targeted for a “jobs program” appears to be another boondoggle, although notably well-intentioned. A “green jobs training program,” created for people to work in the private sector in energy service companies, makes more sense. These folks would weatherize homes, deploy smart meters, work on infrastructure and mass transit. Unfortunately, the government does not have the skill set of an EPC contractor. Why waste time and money reinventing the wheel? Why recreate the SynFuels fiasco of the 1970s which wasted $3 billion and did not produce any fuel? Government can't deliver results and can't get the job done if there is no infrastructure and no accountability in place.

Linking the carbon auction to revenues for energy efficiency must be done in a dedicated fund. It must not exist for the use of general revenues. Does anyone remember what happened to all the Social Security Trust funds? Growing budget gaps will make it difficult to keep the revenues flowing long term for energy efficiency, as the temptation will be too great to use these funds for other Federal budget shortfalls. On the other hand, if green jobs are funded by general revenues, then we grow the deficit. The better solution: Incent the private sector, including renewable energy tax refunds.

The Holy Grail Still Remains a Price for Carbon

While there is superfluous discussion about carbon taxes, the fact is that politicians and the U.S. public do not like higher taxes. Taxes cannot be guised as anything else but what they are: taxes! It seems to me that the carbon tax argument is a love affair of economists who don't know political reality. President Jimmy Carter could not get a modest five cent per gallon gasoline tax increase through Congress over a 10 year period. President Bill Clinton couldn't get his BTU tax proposal through Congress in his first administration. You only have to look at the political pandering on energy to remember last spring's proposals for a gasoline tax holiday for the summer that would have sent the wrong signal to consumers.

That leaves us with U.S. carbon cap and trade legislation. It will be cap and trade, invented by the United Sates in the Acid Rain program in 1995, and proposed by the U.S. delegation at the Rio Climate meetings in 1992. The United States **invented** cap and trade (not the European Union!), as well as most of the body of environmental law. Today we have 38 compliance-driven environmental financial markets in America. Cap and trade will be another compliance driven market with transparency, registries, price discovery and financial sanctions for noncompliance.

The regulatory regime for that solution will come when Congress and the Obama Administration understand that markets have volatility, need no price caps and must feature financial pain for noncompliance. The nonsense that it won't work begs the questions that 184 countries are part of the Kyoto Protocol and they follow market-based solutions. However flawed Kyoto Protocol is, the fact is that it exists and that emissions trading was invented in the United States and accepted by the 184 Kyoto signatory nations.

Congress Has to Get Market Design Right

I have just returned from Washington D.C. and continue to be concerned about flawed market design for cap and trade. The thinking in D.C. policy circles is still very flawed. Politicians understand cap not but don't understand trade, which means the temptation to cater to every K Street lobbyist and campaign contributor is pervasive.

The most troubling perspective is the price cap on carbon called “the safety valve” which still has broad bipartisan support. This distorts markets and will not provide the necessary incentives needed to stimulate more next-generation cleantech investment. Setting the bar too low with $12 or $20 price caps means that industry can buy its way out of environmental problems. For example, last summer in the EU Emissions Trading Scheme Phase 2, RWE, the big German coal burning utility, burned more coal when oil hit $147 per barrel and compensated by just buying more emissions allowances. That is not the intent of cap and trade. The concept was to switch to more clean burning fuels. Safety valves will bring price distortion to that market. Another example is the Regional Greenhouse Gas Initiative (RGGI) which has proven to create a very modest price for carbon ($3.07 per ton) because of over allocation of emissions allowances. Setting the bar too low doesn't incent the desired business behavior which is to invest substantially in cleaner energy.

The real economic incentive behind carbon cap and trade is to provide enough financial pain to change behavior and not to continue in a business-as-usual way. That also creates the proper economic initiatives for smaller cleantech companies to provide solutions. Innovation cannot be predicted, but must be encouraged.

Hit the Ground Running on Green

The Green Agenda appears to be taking a bold and multifaceted shape. The agenda includes Smart Grid, clean coal with carbon capture and storage, and a national RPS to build out more solar arrays and wind farms. Raising CAFÉ standards and increasing building and appliance efficiency standards are also said to on the table from the Obama folks. I am still concerned about biofuels mania which adds little value, outside of converting agricultural waste and municipal solid waste to ethanol. I shudder every time President-elect Obama talks about biodiesel as if that is a panacea for a 250 million vehicle fleet that runs on oil products not soybeans, coal, compressed natural gas, hydrogen, electricity, etc. A 60 billion gallon biofuels mandate would be a financial and food debacle. Advanced biofuels, currently hyped-up, are not commercial yet. And, of course, there are wonderful people working in the weeds on algae fuels (at last count 22 start ups).

Big Impacts are Needed on Energy and Environment

Incrementalism is the way of Congress and all bureaucracies. It is comfortable for them to maintain the status quo and make small changes. That policy has failed the United States on energy issues for the past 30 years. The metrics of energy are not only tech, as the venture capital community knows well. Energy is capital intensive with long lead times. The energy industry will not produce the technology for its future to any great degree, but will buy that technology, taking a page out of the Big Pharma model in biotech. That leaves us with the conundrum of how to get small companies to scale in a capital market signaling scarce capital.

The next two to three years of lower oil prices are a window for the United States to commit massively to energy and environmental infrastructure and to begin a period of lessening dependence on oil. That means massive deployment of plug and play hybrids that use power from the grid off peak and gasoline and diesel from the existing oil infrastructure. That will clip oil demand by four million b/d by 2020. The scale needs to be tens of millions of vehicles, a tax on gas guzzlers, and a retirement of older, inefficient cars and trucks. This means a patriotic imperative to commit to a cleaner and greener energy and environmental future. Are we up to the task?

In times of great economic upheaval, civilizations must respond to the crisis. They either rise to the occasion or collapse. The United States is on the precipice. The financial black hole may be $11 to $12 trillion. The banks are lying. Their financial losses will continue to be revealed through next summer. A crisis demands vision, boldness and action, not more economic studies, committees and commissions. The climate change law in California was only13 pages long. It got the job done. The Energy Policy Act of 2005 was 1,700 pages long, creating a field day for lobbyists and lawyers. We need clear long-term rules on climate change, renewable portfolio standards, tailpipe emissions and long term renewable tax credits from day one. By setting up the policy framework, aka the “rules of the game,” the capital markets will respond.

Regulatory certainty provides financial certainty. Goldman Sachs and private equity funds in New York are now hiring in Green. I think they see through the tea leaves. To create a robust, long-term sustainable green economic strategy requires boldness, vision and direct action from both the Obama Administration and Congress. This also means "hard ball" politics to get the job done. Is complacent, rich and scared America up to this challenge? I truly hope so or economic collapse and decline will be the road more traveled.

I wish all **Issue*Alert*** readers a very happy holiday season!

Peter C. Fusaro is a long time advocate of long term energy and environmental policies that are market driven. He is holding his first 2009 "Introduction to Carbon Trading" in New York on January 14, 2009 (www.pgsenergy.com).