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This is one carbon tax that must be used to beat fuel poverty

The new government has stated that there should be a floor price for carbon. This could be a nice little earner for the Treasury. But will the money end up funding energy efficiency improvements?

The coalition government statement is simple, and it is unequivocal. There will be "a floor price for carbon" introduced.

Delivering upon this commitment will lead to the most dramatic change in the British energy market in a generation. It will ensure realisation of one of the two primary objectives that the European emissions trading scheme was created to achieve – a dramatic shift towards decarbonisation of electricity generation.

It could also deliver the second primary objective of the EU:ETS, a fundamental improvement to the efficient use of energy. But only if the coalition seizes the unique opportunity which this fiscal revolution provides.

At the turn of the century, the founding fathers of the EU:ETS thought they had created a trading system which would deliver a low-carbon economy, using the most established market mechanism of all: a trading system. The idea was that by placing an overt price on carbon emissions, this would militate against investment in fossil fuel generation, and in favour of less carbon-intensive sources. At the same time, it would increase prices sufficiently to change profligate behaviour – initially among the energy intensive companies that participate, but then among all electricity users.

Certainly the last objective has not been achieved. Why? Well, market prices work via supply and demand. If supply is scarce, the price goes up. Too plentiful, and it collapses. Right now, and for the foreseeable future, there are far too many ETS permits sloshing around the European system, owing both to the recession and the over-generous provision of free permits by the 27 governments.

The Climate Change Committee (CCC) is charged with ensuring that UK governments comply with the requirements of the 2008 Climate Change Act. A firm trajectory towards cutting emissions by 80 per cent by 2050 is required. The CCC has scenarios to show how this can be done most effectively. These designate an absolutely pivotal role to the EU: ETS. But only for so long as the price is high enough.

The CCC working model requires a price to 2020 of some Euro 56 per tonne of carbon. Effectively, the "floor price" required. But the traded price of carbon is currently around one-third of that. Indeed when earlier this year, the government auctioned some of the (tiny) amount it is permitted to sell, rather than give away, the sale price was down at only 25 per cent of the CCC's recommended figure.

Unilaterally the UK government cannot change the traded price. But it can inspect the emissions permit portfolios of the big generators at the end of each year. And it can estimate the difference between the value of these, and the CCC recommended "floor price". And directly levy the difference - in essence, creating a carbon tax on the electricity generators.

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The sums involved are mouth-watering. We calculate that the difference between today's market price (circa Euro 16) and the price needed to comply with the Climate Change Act (Euro 56) for a tonne of carbon is enormous. Like about £5.8bn. And that is a sum recurring every year that differential remains.

This is big money. Which the Treasury must be salivating to acquire. This revenue stream does diminish the less carbon intensive the system becomes, and the less electricity is consumed. So the money raisers at the Treasury may yet develop a vested interest in retaining the status quo.

The generators will not swallow the tax. Indeed they already charge all customers for the EU:ETS scheme, even though almost all their permits were given free. A windfall worth £9bn according to the regulator OFGEM. We estimate that taking the cost of the EU:ETS up to Euro 56 per tonne could by itself increase fuel bills by at least a quarter.

When you consider all the other ecological costs due to be passed through to customers (funding carbon capture and storage; the renewables obligation; feed-in tariffs; the carbon emissions reduction target; the renewable heat incentive etc), you can see we have a very significant outcome. A lot of companies will find their fuel bills rocketing. For those fixed in the UK , that might at least lead to a greater willingness to invest in energy-saving measures.

The same goes for relatively affluent households. But equally there is a growing number of households (6m and rising) which are even now deemed to be in fuel poverty - needing to spend over 10 per cent of disposable income just to keep warm and lit. Without intervention, that number will grow. Existing remedial schemes like Warm Front are over-subscribed and cash-starved: this year they are set to help just 3 per cent of eligible households.

The coalition statement is effusive on matters ecological, strangely silent on issues like poverty and social deprivation. This new carbon tax will be a nice little earner for many years to come for the Treasury. It would be only right were the bulk of these new revenues to be earmarked to improving the energy performance of homes as well as companies. Which in turn would reduce carbon emissions still further. z

FURTHER INFORMATION
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