Effective carbon pricing to support and enable a proactive transition to low carbon generation

This is the first in a series of blog posts from NextEnergy Capital, outlining an array of policy proposals which we believe would, if implemented, herald in the low carbon energy transition and deliver a subsidy free and effective low carbon economy. In this first blog, we will examine the need for and benefits of a wholly new approach to carbon pricing.

The UK is committed to lowering its carbon emissions and transitioning to a low carbon economy. We have already taken several positive steps towards achieving this goal, such as the phasing out of unabated coal fired power stations by 2025.

However, the transition to a low carbon economy cannot be delivered by Government alone, and a fresh approach is required in order to ensure the market has both the incentive and opportunity to achieve this transition.

To that end, an effective carbon pricing model would tackle many of the challenges currently facing our low carbon energy transition. At present, the ability of energy suppliers to avoid carbon taxes by passing the cost on to consumers removes any incentive for those suppliers to shift to low carbon forms of energy generation.

A carbon pricing model mandating that the ‘polluter pays’ is needed to truly drive the avoidance strategies of energy supply companies. With this principle in place, suppliers will either switch to low carbon energy generation, or ensure that their generation arm invests in low carbon technologies, in order to avoid future costs.

Establishing a ‘polluter pays’ principle is one thing, but in order to build momentum for the low carbon transition, an effective carbon pricing model must be implemented in the right way. Taking a long term approach to this is the key to success.

Providing a 30 year ‘flight path’ for the carbon price to increase progressively over time will ensure that implementation is both effective and responsible. It will be important to provide a reasonable timeframe for the owners of ‘stranded’ carbon emitting assets to consider their options, recoup their investments, or make the necessary adjustments. Providing this clarity upfront will help build consensus across the energy sector, ensuring that carbon pricing does not become a punitive measure, but instead something that industry as a whole can get behind.

Effective carbon pricing in this vein would thus trigger a change in the strategies of large energy supply companies, as they seek investment in low carbon technologies – like solar – as the only means of avoiding the costs associated with emitting carbon.

In the UK, the timing of this comes at a point when the current generation fleet is ageing and will require replacement, sooner rather than later. If the market were to invest heavily in new, conventional, carbon emitting generation now, the market would be loathed to write this investment off decades earlier than planned due to a reversal in policy direction later down the line. Potential loss of returns for investors, or worse still, the cost of compensation from Government is something that must be avoided.

Implementation of an effective carbon pricing model will be a delicate balance. A progressive increase in the carbon price is important, but we mustn’t go too far the other way. If for instance the increase is too steep, the cost of deploying renewables will also increase, with demand being such that developers will charge higher sums. The carbon price trajectory has to be set just right, and with this the demand curve will be shallow and suppliers will be able to adjust without frenetic avoidance.

Whilst this vision of an effective carbon pricing model deliberately aims to drive energy supply companies' strategies to deliver low carbon generation, it is essential that Government does not overstep the mark, remains technology neutral and allows the market to deliver the solution.

Government commitment to a long term 'flight path' on carbon pricing now, will demonstrate real support for the low carbon energy transition, avoid retrospective policy changes and reinforce investor confidence.

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