

Suite 502

1150 Seventeenth Street, N.W., Washington, D.C. 20036

Telephone: (202) 777-3000 Facsimile: (202) 777-3010

ECONOMIC NEWS UPDATE

IRWIN M. STELZER

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The gathering of 189 nations in Montreal at the Climate Change Conference ended last Friday as most UN-sponsored conferences end these days: with denunciations of the United States. Canadian Prime Minister Paul Martin sent a message to “reticent nations, including the U.S.....there is such a thing as global conscience and now is the time to listen to it.” Jennifer Morgan, director of the climate change project at the World Wildlife Foundation, said that American’s refusal to sign on to the Kyoto approach “shows just how willing the U.S. administration is to walk away from a healthy planet and its responsibilities to its own people.”

But the richest -- as in, that’s rich -- comment came from former President Bill Clinton. In what The New York Times describes as “a hastily arranged speech”, the very man who during his tenure in the Oval Office refused to submit the Kyoto Protocol to the Senate for ratification had this to say about President Bush’s continuation of the Clinton policy, “I think it’s crazy for us to play games with our children’s future. We know what’s happening to the climate, we have a predictable set of

consequences if we continue to pour greenhouse gases into the atmosphere, and we know we have an alternative that will lead us to greater prosperity.” Supporters of that alternative -- extending the Kyoto emissions limits beyond 2012 -- reacted with what The New York Times’ Andrew Revkin described as “waves of applause,” unheard by Dr. Harlan L. Watson, America’s chief negotiator, who walked out of the informal discussion phase of the Montreal meeting on Thursday evening rather than remain a passive receptor of abuse.

Never mind that many of the enthusiastic delegates represented nations that have failed to cut their emissions to meet their Kyoto Treaty obligations. It seem that job-creating economic growth trumps environmental concerns, as British Prime Minister Tony Blair, sufficiently worried about global warming to favor a new round of construction of nuclear plants, ruefully noted in a typically candid appraisal of the effectiveness of the Kyoto emission caps: “The blunt truth about the politics of climate change is that no country will

want to sacrifice its economy in order to meet this challenge.”

That did not deter his environment minister, Margaret Beckett, from claiming that the 15 older EU countries are on a path to meet their Kyoto obligations by reducing their 1990 greenhouse gas emissions by 9.3 percent by 2010. Italy, Japan, Ireland, Canada, and Spain have so far shown no sign of being able to cut their emissions by anything like that amount: all are actually producing greenhouse gases in excess of, rather than below, the 1990 baseline levels. Both because its economy is in the doldrums, and it has shut down uneconomic and highly polluting Soviet-era factories in the East, Germany is one of the few countries likely to meet its targets.

The delegates agreed to allow poorer nations to count their rainforests as repositories for carbon dioxide, which would make them eligible for economic assistance, and offered China financial and technological inducements to accept caps on the emissions associated with its rapid economic growth and emergence from poverty. But it is unlikely that the major developing countries such as India, China, South Africa and Brazil will sign on to Kyoto as it is now drafted. These countries have shown no inclination to stifle their growth in order to accommodate the richer nations who have signed the Kyoto treaty, or to invest in uneconomic energy-saving technologies and devices.

Indeed, when the energy crunches come, the developed nations' politicians quickly shed their green clothes. Last week the OPEC oil cartel hinted at, and then denied plans to respond to mounting inventories in consuming countries by cutting

production in order to sustain crude oil prices in the \$60+ per barrel range. That hint sent consuming countries' policymakers into a spin: they want OPEC to pump more, not less oil to feed their thirsty cars, trucks and factories, and to heat the homes of those who have not switched to natural gas. Oh yes, burning that oil will produce more greenhouse gas emissions, but that's a problem for still another international conference.

The President, too, has in mind the consequences U.S. adoption of the Kyoto targets might have on economic growth. Besides, in 1997 the Senate adopted the 1997 Byrd-Hagel Resolution by a vote of 95-0, warning then-President Clinton not to sign any climate-change agreement that “would result in serious harm to the economy.” The delegates at the Montreal meeting may have been buoyed by a report by 25 U.S. economists, including three Nobel laureates, that American participation would cut only 1% off its GDP. But although the jobs loss associated with such a cut of billions in output doesn't sound like much to academics with lifetime tenure, it is a nontrivial number to those responsible for maintaining a rapidly growing economy, and who are appropriately suspicious of sophisticated economic modelers of the sort who brought down Long Term Capital and, almost, the U.S. financial system. The most important feature of U.S. environmental policy remains the development of clean coal technology and its transfer to developing nations, and the increased use of natural gas from domestic sources, or from overseas via the liquified natural gas (LNG) terminals that can be built now that the administration has simplified the permitting process.

But natural gas is only a relatively clean fuel: it is far from emission-free. No matter. European politicians who have been chiding America for its environmental carelessness suddenly find themselves faced with possible shortages of this source of energy, on which many of their factories rely. No surprise that they are now less concerned about the emissions resulting from the burning of natural gas than about shortages that might force some of their factories to shut down during periods of peak use of that fuel by homeowners trying to keep their houses warm as winter takes hold. Fears that a price dispute between producer and transporter -- Russia and Ukraine, respectively -- might lead to a cut-off of supplies have German and other EU politicians sweating, despite the emissions reductions that would result should Vladimir Putin decide to close Russia's valves. Hell hath no fury like that of a workman (read, voter) laid off because his government's environmental policy has resulted in an energy shortage.

Which brings us to renewable energy sources. Wind and solar energy are playing and will play an increasingly important role in meeting the world's growing need for energy but, even with the encouragement of the various subsidies on offer in many countries, they cannot replace the massive amounts of energy produced by coal- and gas-fired power stations, and by nuclear plants. Besides, these sources are not without consequences for the environment, witness the NIMBY attitude towards wind machines.

No need to spend time on the President's efforts to open Alaska to further drilling. Even after the run-up in oil and gasoline prices he has at this

writing been unable to marshal congressional support for drilling in ANWAR, and even if he could, the reserves there are too inconsequential to make a significant dent in our reliance on oil supplied by the likes of the House of Saud and Venezuela's Hugo Chávez, when that oil can be brought to market a decade from now.

Which reduces the options for increasing energy supplies without contributing to greenhouse gas emissions to three: clean coal technology, conservation, and nuclear power. America is pioneering the first of these options, which may well be the most important if China goes ahead with plans to build hundreds of coal plants, and if American firms build even some of the 90 plants they now claim to have on the drawing boards. The President has got this one right: he is pushing such technology both because we have ample supplies of coal, and because the international market for such technology might prove significant enough to allow us to chip away at our rather large trade deficit.

As for conservation, it remains an important factor. Because vehicles have become more efficient, and factories more energy-stingy, energy use per unit of GDP has declined sharply. That enabled the US economy to shrug off high crude oil and petrol prices that followed Katrina, and that in an earlier time combined with some inept policy reactions to produce severe economic downturns. But the attractiveness of conservation is and will remain largely, although not entirely, a function of energy prices, witness the stocks of unsold SUVs decorating dealers' lots in the aftermath of \$3 gasoline. Sensible, cost-effective regulation can help where markets are not functioning as they

should, but a great deal of that low-hanging fruit has already been picked.

Then there is nuclear, the new darling of policymakers the world over, to the glee of GE, Westinghouse and others eager to end a decades-long drought of American orders. At least eight U.S. companies have announced an intention to pursue construction licenses. But none has yet committed to build a new nuclear station. One of the utility industry's shrewdest and most successful operators tells me that until the problem of disposal of the waste produced by these plants is solved, he will restrain his engineers, who are champing at the bit to get started on another round of nuclear plant construction.

That problem is far from solution. The best site for depositing the waste remains Yucca Mountain, unfortunately located in Nevada, the home state of the Senate minority leader Harry Reid, who has sworn to prevent the use of that site. Result: stalemate. Unless, of course, some of the companies that are considering building nukes decide they can continue to store the waste in the hundreds of ponds that dot the American landscape, to the increasing consternation of Homeland Security officials.

If any of the potential sponsors of new plants do go forward, the best guess is that the earliest plant might come on line some time in 2016. That plant will likely be located in the South, where competition has not replaced old-style regulation, meaning that the owners of these facilities would be shielded from the competition with fossil fuels that prevails in electricity markets in other parts of the United States. Instead of counting on an ability to compete for customers, these

companies would rely on their regulators to let them earn a reasonable return on their investment -- a reliance that in the past has not proved able to survive the rate increases that regulators would have had to approve to cover the high costs of this technology.

Which explains the excitement being generated by Finland, where a new model Areva EPR (Evolutionary Pressurized Reactor) is actually under construction by TVO (Teollisuuden Voima OY). It is not certain, however, that EPR technology is the answer to the high cost of constructing and operating nuclear power plants. Most American companies are less enthusiastic than their European counterparts about this new model: they tell me, on a not-for-attribution basis, that the Areva EPR is some 33% more costly to build than the technologies on offer from GE and Westinghouse, and is well behind competing models in securing the necessary approval of the Nuclear Regulatory Commission, which probably won't come for the Areva EPR design until 2009. Other non-enthusiasts for the plans of many countries to build nuclear plants include the anti-proliferation experts in the Pentagon and the White House.

In the end, the prospects for nuclear power will depend heavily on three things: the forecasted price of competing fossil fuels; the expected cost of the carbon permits that users of coal, natural gas and oil will buy; and the extent to which governments streamline licensing approvals and, very likely, subsidize nuclear power. Such subsidies might take the form of government guaranteeing the price of the nuclear-generated electricity, or making a convincing promise to bear the costs of waste disposal and

decommissioning. That such subsidies of nuclear power are the most efficient way to meet U.S. energy requirements is hotly disputed by advocates of alternative production technologies, and by groups that argue it would be cheaper to cut back on the demand for power.

To that list of determinants of the future of nuclear power I would add the risk tolerance of investors who have seen American companies take ruinous losses on plants built during the last wave of enthusiasm for nuclear power. It may well be that Investors have short memories, which would be a plus for the current crop of nuclear advocates. But even memory-deficient investors are likely to demand a substantial risk premium before making available the billions that a new nuclear program would require. After all, government guarantees are by their nature not necessarily carved in stone, there being no certain means by which any government making such promises can bind its successors.

Dr. Stelzer has served as consultant to many energy companies and currently consults for a leading developer of wind farms.



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