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Belmores Wealth Management

# A step in the right direction?

Snapshot

**Australia's emissions trading scheme may have received a frosty reception in the Senate, but the market for green technology is heating up regardless. Whatever may be decided in the various national and international forums, climate change is already big business.**

### Finding the new way

While politicians squabble about the level of emission cuts and the relative merits of future energy sources, major companies are already working for a greener future. Australian investors can buy shares in companies developing alternative sources of energy such as wind, hydro, and geothermal or "hot rocks". This is in addition to major capital expenditure on gas, especially the coal-seam variety. Gas is not renewable, but it is a lower-emission alternative to "dirty" coal used in power stations.

Out of this grab bag of new technologies some will undoubtedly emerge as winners. But the viability of companies on both sides of the green and brown energy divide depends on the speed with which governments around the world move to replace old technology, the pollution reduction targets they agree to, and the methods they adopt to regulate emissions.

### What is an ETS?

The Australian government, along with the United States and European nations, is committed to the introduction of an emissions trading scheme (ETS). But as the recent climate change summit in Copenhagen demonstrated, the devil is in the detail. There is fierce debate not only about carbon reduction targets, but also about whether an ETS or options like carbon taxes are the best way to tackle climate change.

In essence, an ETS uses market forces to put a price on harmful greenhouse gases. These include carbon dioxide, methane, nitrous oxide and ozone, the major gases described by the term "carbon emissions".

An ETS is often referred to as a cap-and-trade system because it caps the level of emissions and establishes a market for the free trade of carbon permits. Companies must hold permits equal to the amount of pollution they create.

### Impact of pricing carbon

If a price is put on carbon, so the argument goes, there is a price point at which coal will be phased out and renewable technologies will become cost efficient. So by putting a price on carbon emissions, and making the biggest polluters pay, governments intend to control and reduce emissions over time.

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Some carbon permits will be provided free as a transition measure, others can be bought on the open market from green energy producers such as forestry companies, or from householders who install solar power.

As the total cap is reduced, permits become scarce and hence more expensive. If the market works efficiently, this should encourage companies to reduce their emissions. However, if too many permits are issued for free, there will be less incentive for companies to make changes.

### Impact on the Economy

The "Yes" camp argues an emissions trading scheme with firm targets will provide certainty for businesses as well as incentives for business and households to reduce pollution and improve energy efficiency.

According to Treasury projections[1], an ETS would add around 1 per cent to average household costs over the first two years of the scheme. The main direct cost would be in gas and electricity bills which are expected to go up by an average of $300 a year. But for most low- and middle-income households that receive the government's compensation package, the net impact would be zero or positive.

The "No" camp says the economy will suffer if Australia adopts an emissions trading system before the United States and other major economies. They argue the cost of doing business in Australia will be more expensive, jobs will be lost and companies will be competing against overseas producers who are not penalised for their carbon emissions. Inevitably, these costs would be passed on to ordinary Australians.

### Winners and Losers

Some of the biggest losers from an ETS or any attempt to rein in big polluters will be coal-fired power generators and energy intensive industries such as the mining, petrochemicals and heavy industry.

But there will also be winners, notably in the gas sector. Gas suppliers AGL and Origin Energy have already invested heavily in renewable energy such as wind, hydro, solar and geothermal. Major gas producers like Santos and Woodside Petroleum also stand to gain.

Some smaller renewable energy companies are already popular with some investors. Geodynamics is the most advanced in the geothermal sector, Carnegie Wave Energy is a leader in wave technology, and Energy Developments generates electricity from garbage dumps.

### What's next?

In many ways, the future is already here. But there is still uncertainty which both markets and investors dislike. Pressure will continue on governments to make decisions about emission targets and the method of pollution reduction. These decisions will shape the investment landscape for decades to come. For individual investors there are decisions that need to be made about the new investment opportunities that are opening up, and about risks to current investments in sectors that might lose ground.

From an investment perspective, some of this information will already be factored into share prices – it's important to note the companies discussed in this article are not recommendations to buy or sell. If you would like to discuss your portfolio with us, please don't hesitate to call us for a chat.

1. Treasury projections available on www.treasury.gov.au/lowpollutionfuture

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