The Relevance (and Likelihood) of Action on Carbon in a post-Trump World

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The election of Donald Trump and his recent cabinet nominations of individuals who have been described in the mainstream U.S media climate skeptics, including Scott Pruitt (Environmental Protection Agency), Rick Perry (Department of Energy) and Rex Tillerson, the former CEO of ExxonMobil (Department of State), has many questioning the integrity of proposed domestic and international carbon pricing schemes. As a result of the election, the conversation has turned away from the recent momentum of post-Paris climate mandates, to the ramifications if the United Stated decides to abandon its climate commitments. In light of Trump's inauguration as the 45th president of the United States, it is worthwhile to examine the outlook for carbon regulation and pricing in a post-Trump world. Many market analysts initially expect that the direction of the Trump administration on climate change will have potentially far-reaching implications. We will examine this topic and the sub-themes we identify below in follow-up blog pieces in the weeks ahead.

Federal Action and State Actors

In the United States, the federal government's ability to influence climate change regulation is largely accomplished through the conduit of the EPA and the Clean Air Act. The new U.S. Federal government will certainly have an impact on the direction of the EPA and the administration and implementation of the Clean Air Act. Many of the obstacles that have prevented environmental regulation in the past (and which critics have cited as reasons for slow action at the federal level in the U.S. on climate change and similar matters) will work against reversing the regulation and regulatory landscape in place in the future. In a recent interview, Ms. McCarthy (the current head of the EPA under the Obama administration), stated that just as she had to provide a scientific foundation for her regulations to curb carbon dioxide emissions, the Trump administration would be required by the Clean Air Act to show that any attempt to tear up the regulations is supported by science.[1] In other words, an onerous standard of proof can act as a double edged sword, one that makes change difficult in either direction.

Outside of the EPA, we understand that the majority of carbon and climate change regulation is enacted at the state level, which would allow individual U.S. states to move forward on carbon pricing mandates (for instance) without Federal support. Even if the Trump administration adopts a stagnant approach towards carbon pricing and regulation, we are still likely to see action, albeit polarized, at the state level, particularly in jurisdictions such as California, which has taken a leadership role in regulating carbon emissions for over a decade.

The Clean Power Plan

Throughout his campaign, Donald Trump expressed support for the coal industry and vowed to undo the Clean Power Plan. By way of background, the United States still derives 33% of its electricity from coal (compared to 9.5% in Canada).[2] The informal mandate of the Clean Power Plan is to transition the United States economy away from coal fired generation towards cleaner power sources, including natural gas and renewables. Doing so would bring the United States closer to achieving its 2030 climate commitments under the Paris Agreement. While the removal of the Clean Power Plan would be an obvious blow to United States climate policy, it would merely delay the inevitable. Under most current carbon pricing metrics, absent an exemption or free credit allocation, coal plants are largely uneconomical. As state actors begin implementing their own carbon plans, coal generation is expected to be priced out of the market. In addition, recent decreases in the price of natural gas and the growth in renewables, such as wind and solar, rather than the impact of the Clean Power Plan or other government legislation, are at the heart of coal's relative decline. We will continue to examine how the Clean Power Plan may be delayed, discarded or adjusted in the coming months and what other factors may impact the coal industry in the U.S.

Private Markets and Risk Allocation

While government policy can significantly impact changes in corporate behavior, the transition away from coal to natural gas and renewables is largely driven by private market mechanics. Private actors invest in natural gas and renewables because they offer the highest level of risk adjusted return, not out of altruistic motives. The private market is increasingly incorporating carbon pricing into their risk analysis and investment decisions and project proponents at least consider the carbon "shadow price" in their financial metrics regardless of government policy.

With a long-term investment horizon, often approaching 30-40 years, most infrastructure projects currently in the planning phase will long outlive a Trump presidency. The views of one administration are largely irrelevant as project proponents must consider the risk of increased costs associated with carbon emissions over a project's useful lifetime. Investment in natural gas and renewables and other carbon friendly projects will continue so long as project proponents take the view that carbon pricing is an inevitable cost of doing business in the 21st century.

The above topics will be examined in more detail in the coming weeks. For now, there is reason to believe that U.S. Federal plans, strategies or inaction on climate change and carbon policy may not signal the end for carbon regulation. Other factors (beyond Federal US government policy and regulation) may be as important or more important in dictating the nature and extent of industry initiatives to mitigate carbon emissions whether in the U.S., Canada or elsewhere.

[1]https://www.ft.com/content/e4759fea-c491-11e6-8f29-9445cac8966f

[2]https://www.eia.gov/tools/faqs/faq.cfm?id=427&t=3 (US);
https://www.nrcan.gc.ca/sites/www.nrcan.gc.ca/files/energy/pdf/EnergyFactBook_2016_17_En.pdf (CAN)