

POLITICAL ECONOMIC PERSPECTIVES OF CLIMATE POLICY

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OVERVIEW

- Present political economy perspectives on climate policy with a focus on carbon markets
 - Introduction
 - Economic theory: permits versus taxes
 - Public Choice approach to EU ETS
 - Other “Political Economy” approaches
 - Designing policy when political economy matters

INTRODUCTION

- Despite legitimacy issues (climate fraud, weak carbon prices) faith in carbon markets as a central component of a global policy remains strong
- Carbon markets:
 - cost effective and flexible
 - aligned with “neoliberal” ideologies
 - preferred option of powerful: US made it condition of Kyoto, domestic industries liked it, developing countries saw transfers
 - “an historically unparalleled experiment in marketised environmental governance” (Newell et al 2012, p. 3)

INTRODUCTION

- Public choice approach:
 - "Why the patient does not follow the doctor's orders?" (paraphrasing Hahn (1989)), or why haven't economic instruments been used more widely?
- Political theorists or political economists of the more classical tradition the question is turned on its head:
 - What can account for the breathtaking spread of markets for emissions and commodification of 'nature'?
 - Answer lies in ascendancy of neoliberalism

INTRODUCTION

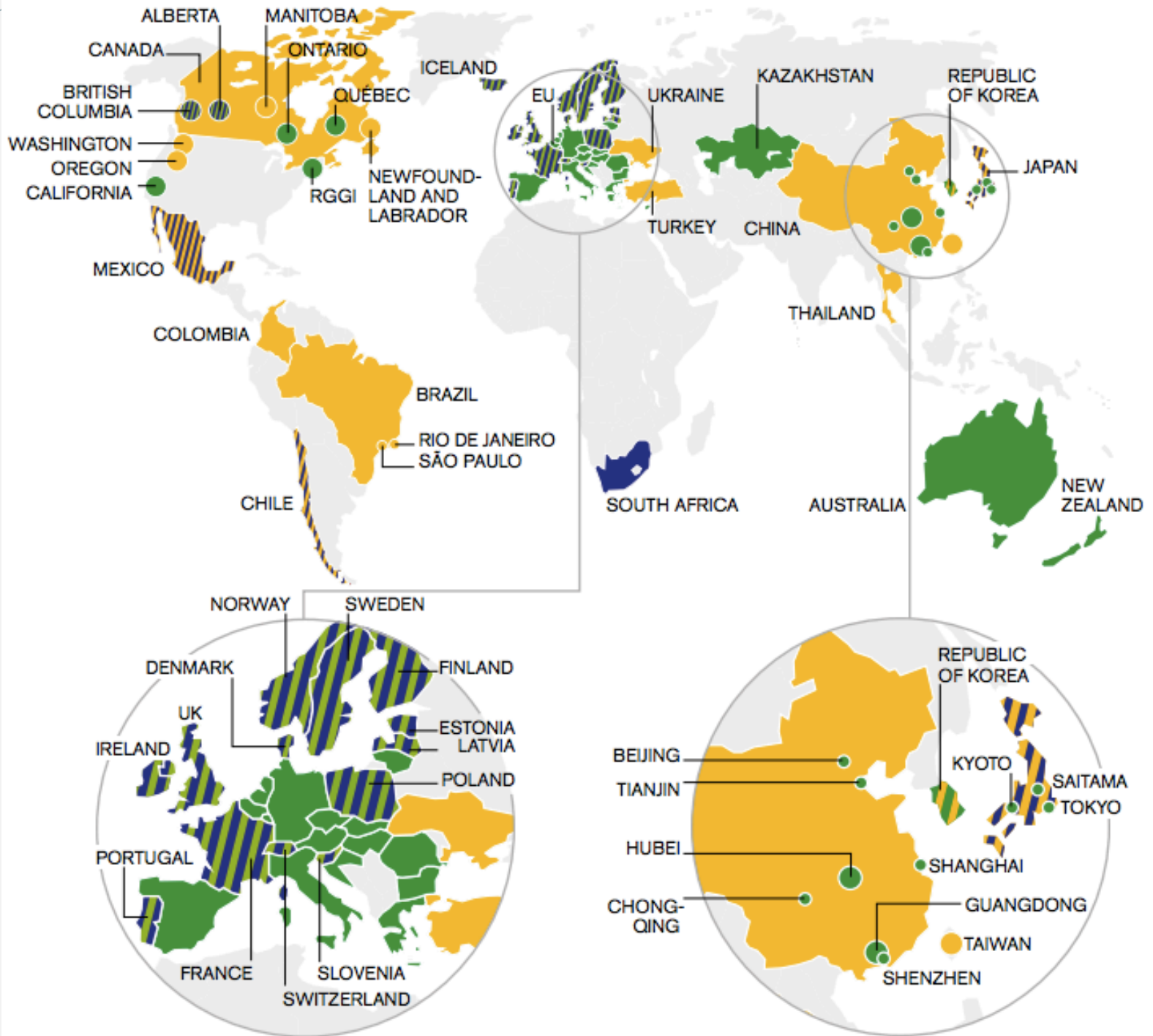
- Understanding the policy process is important:
 - both to explain existing policy
 - because of the pressing reality that too little is being done
 - to correct political failures
 - to design policies that will be effective and taken up
 - Fifth Assessment Report of the IPCC (2014) highlights importance

UNPRECEDENTED MARKET FAILURE

- Causes and consequences of climate change are global, all human activity involved, impacts everywhere
- Economic analysis of relatively small or marginal projects long history but for large, non-marginal impacts affecting every economic activity, these methodologies confront serious strains
- Multiple market failures renders first best policy inadequate
 - negative externalities GHG emission activities
 - public good nature of innovation and diffusion, adoption of energy efficient technologies, infrastructure projects, urban planning, modes of transportation
 - No single instrument like a carbon price is enough

PERMITS VERSUS TAXES

- Few jurisdictions use carbon tax and generally at low level
- Emission trading has evolved from a textbook idea (Dales 1968) to a major instrument in pollution control
- Most economists agree on need for a carbon price though differ on stringency and policy tool (taxes versus permits)
- Recent rise in interest in the US for the use of a carbon tax partly because of the inability of passing a cap-and-trade and partly for the potential to raise revenues as part of a broader tax reform



PERMITS VS TAX (ECONOMIC THEORY)

GOULDER AND SCHEIN (2013)

Issue	Carbon Tax	Hybrid	(Pure) Cap and Trade
Minimize administrative Costs	x		
Avoid Price Volatility	x	x	
Address Uncertainty			
Weitzman issue (price vs emissions uncertainty)	x	x	
Murray-Newell-Pizer issue (flexibility to respond to new information)		x	x
Avoid Leakage from "Nested" Regulation	x	x	
Avoid Large Wealth Transfers to Oil Exporting Countries	x	x	
Achieve Revenue-Neutrality, Promote Border Tax Reform	x		
Achieve Linkages across jurisdictions	?	?	?
Achieve Benefits from Broad Sectoral Coverage	?	?	?
Achieve Greater Political Support	?	?	?

PERMITS VS TAXES

- Differences highlighted include the view that carbon tax is better able to
 - (a) achieve a fair distribution of the policy burden between polluters (firms) and consumers
 - (b) to preserve international competitiveness, and
 - (c) to avoid problems related to the verification of “emissions offsets”
- **Appropriate design can eliminate differences (hybrid)**
- Design of instrument may be more important than choice

PUBLIC CHOICE APPROACH TO EU ETS

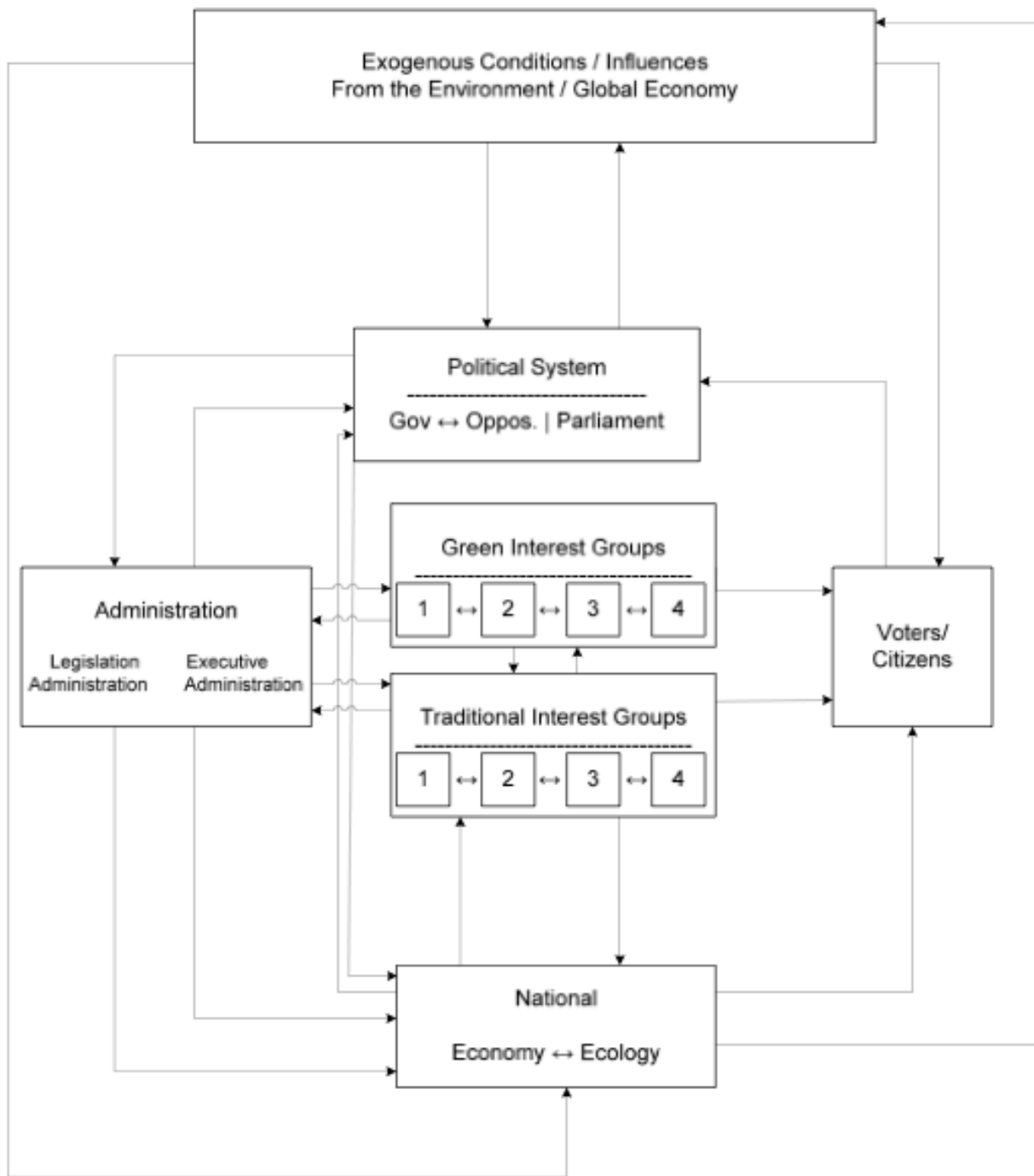
- Public choice theory has tried to explain inadequate uptake of economic instruments by extending assumptions about individual motivation to political sphere
- Initial pessimistic models: Olson (1965) difficult to organise when benefits spread out thinly, Stigler (1975) regulation dominated by industry
 - But environmental legislation furthered counter to pessimism
- Optimistic models: models show that interest group competition can maximize social welfare (Aidt 1998) or when voters are informed interest groups cannot influence policy (Denzau and Munger 1986)

THE RISE OF EU ETS

- From the early 1990s onwards a policy network promoting the desirability of emission trading emerged
- EU Commission initially favored carbon tax but opposed by industry and required unanimity among EU members
- Economists and producers organised as a network informally and through UNCED published a report on emission trading in time for the 1992 United Nations Conference on Environment and Development (UNCED)
 - spawned a UK network
 - “Bureaucrats for Emission Trading” (BEST) in the aftermath of Kyoto involved a new set of economists in the European Commission
- Grandfathering and lure of windfall profits brought industry aboard

PUBLIC CHOICE APPROACH

- Voters assumed to cast vote to maximize their expected utility
- Politicians cater to median voter
- Emitting industries want to minimize environmental regulation overall
- Lobbyists focus on different parts of process
- Public bureaucracy may prefer command and control



VOTERS

- Diffuse groups succeed in organizing despite the disadvantages
- Ability to bring votes may outweigh the influence of financial resources
- Continued increase over the recent decades in citizen sensitivity to environmental issues
- Unfamiliar and suspicious of economic instruments (worried over price increases): prefer regulation

VOTERS

- A key problem when it comes to the ‘demand’ for climate policy on the part of the public is geographic and temporal mismatch between general benefits of mitigation accruing to society and the private costs that are borne by consumers and citizens
- In this regard theory would suggest that consumers ‘willingness to pay’ (WTP) for climate mitigation will be well below the social benefits of mitigation (Jenkins 2014)
- The lower is the WTP the more likely that political opposition from citizens will mount with more stringent and visible carbon pricing policies
- To the extent that carbon pricing policy is accompanied by rebates or tax offsets the public may be less resistant to carbon pricing

POLITICIANS

- A common modeling approach is to assume that politicians gain utility by being re-elected (Mueller 2003) and accordingly they promote policies that the median voter supports and is willing to pay for (Maux 2009)
- Political ideology sometimes treated as constraint
- If voters lack information on issue and policy instruments we would not expect the median voter to put high priority on climate policy
- Lack of information on voters side gives leeway to interest group influence

POLITICIANS

- Reasons for politicians to favor market instruments could include:
 - (a) the likelihood that politicians are better informed about their efficiency advantages over command and control measures
 - (b) they can generate revenues and thus be used to finance other projects or reduce taxes that may be attractive to the median voter
 - (c) they may be easier to explain to the public as punishment to polluters (Kirchgässner and Schneider 2002)
 - (d) they may have greater control over defining winners and losers (Oberholzer-Gee 2002).

AFFECTED PRODUCERS AND INTEREST GROUPS

- Industries with high concentration of assets may have much to lose with the implementation of carbon pricing and would be expected to mount strong opposition (Murphy 2004)
- The sensitivity to the regulatory environment may be enhanced if these firms engage in cross-border trade and the regulatory changes are specific to their jurisdiction as may well be the case with a carbon price
- Industries that fall into this category include carbon intensive fossil energy sectors like oil and coal mining and extraction or energy intensive firms in globally traded sectors like steel, chemicals and heavy manufacturing

LOBBYING

- There are about 20,000 lobbyists in Brussels to potentially influence 15,000 Commission and European Parliamentary officials
- In general producers will be able to spend more on lobbying than environmental advocacy groups
- Eising (2007) finds that the probability of having weekly contact with the European Commission is %50 higher for those groups that have a budget of 7.5 million euro relative to interest groups without a budget
- In EU-ETS sectors where powerful interest groups had greater representation they were able to get a preferential allocation of allowances and they managed to lower the overall burden within the EU-ETS

LOBBYING

- Green interest groups in the European Union lobby the European Parliament while traditional interest groups focus on the bureaucrats (European Commission) (Gullberg 2008).
- This means that traditional interest groups are more involved in the early stages of policy making and thus are better able to shape the evolution of policy and thus the choices effectively available at the later stages (Kollmann and Schneider 2010).
- EU-ETS: The industries lost in attaining their main objective, which was to install a voluntary system, but once a tradable permit system was decided they were able to attain the most beneficial policy design for the industry

PUBLIC CHOICE AND EU ETS

- EU ETS powerful lobbies are seen as preventing the design of a more effective instrument whether this is a carbon tax or a more stringent cap
- Grandfathering and oversupply of allowances led to early collapse of price of permits and windfall gains
- Phase II went better but eventually financial and economic crisis, renewable deployment, and international offsets, led to low permit price again
- Recent evidence suggests that lack of political credibility of the long term ambition to keep the supply of emissions adequately low is key to low price of permits

MULTIPLE INSTRUMENTS PROS AND CONS (ECONOMIC THEORY)

- Cons:
 - Fankhauser et al. (2010) show how subsidies undermine the carbon price with the ETS and thus increase overall social cost of mitigation
- Pros:
 - Carbon pricing may be too costly to bring behavioral change so need energy efficiency standards and labelling for appliances, buildings and fuel economy (information asymmetries, cognitive failures)
 - Path dependence in energy technologies may require initial support beyond price (Aghion 2012)

MULTIPLE INSTRUMENTS PROS AND CONS (PUBLIC CHOICE)

- Cons:
 - High cost may lower public acceptance of these technologies
 - Industry preferred use of multiple instruments like support of RES as they avoided higher carbon prices and politicians give handouts
- Pros:
 - complementary policy of support for renewables could be part of building the constituency needed for stronger climate policy or abetting resistance

ACCOUNTING FOR POLITICAL ECONOMY INTERACTIONS IN POLICY DESIGN

- Gawel et al. (2014) consider how a political bargaining game within the context of multiple policy objectives may provide a rationale for a policy mix
- By leading to lower allowance prices and thus lower abatement costs industry may be less resistant to more stringent caps
- RES policies act as support to those stakeholders advocating stricter emission caps (Bennear and Stavins 2007)
- producers of RES-technologies will be another group lobbying for their use (Jenner et al. 2012)
- RES-support policies could be interpreted as the “political price” to pay for stricter emission caps

POLITICAL ECONOMY CRITICAL OF CARBON MARKETS

- Mirowski (2013) views carbon markets as part of a general strategy of neoliberalism when confronted with a crisis
- Short term response: climate denialism
- Mid term response: instituting trading schemes for carbon emission permits and offsets
- Long term: science fiction geengineering.
- Carbon markets can be seen as part of a depoliticisation of climate change: turning political issues into matters for technocratic management
- Metaphor of "the zombie": 'unkillable nature of apparently defunct neoliberal governance and economic theory' it also expresses the fact that what is taking place occurs without agency (Stephan and Lane 2015)

POLITICAL ECONOMY APPROACH: SUPPORT OF CLIMATE CAPITALISM

- The explosion of enthusiasm for carbon markets between 1997 and 2001 can be identified as an important turning point. A key shift is illustrated by the collapse of the Global Climate Coalition (GCC) bloc that had been vehemently opposed to action prior to Kyoto with numerous of its former members taking a pro-action position
- key component of this new coalition was the finance sector
- financiers would not necessarily be in the pro-climate coalition without carbon markets as the policy response
- the success of carbon markets is that they provide benefits to a particular sector that also happens to be one of the most influential sectors in the latest phase of capitalist development

DESIGNING POLICY WHEN POLITICAL ECONOMY MATTERS

- In the presence of lobbying different approaches have been identified:
- 1. **Lobbying for efficiency** to counterweigh special interest groups (Anthoff and Hahn 2010)...this is a bit like ignoring political economy dimension
- 2. Focus on **fundamental and unlikely changes** in economic structure, institutions and behavior (Spash)
- 3. Helm (2010) suggests **minimizing rent seeking and capture**
 - greater use of market based instruments leaving less room for political intervention and pork barrel (read carbon tax versus EU ETS)
 - Forming of institutional architectures with greater credibility (independent boards choosing targets)
 - Less complex schemes harder to capture

DESIGNING POLICY WHEN POLITICAL ECONOMY MATTERS

- 4. Treating **political feasibility** as an additional important **constraint** to instrument choice and design
 - “Viable policy can neither build on combating the influence of organized interests nor on visionary social change” (Gawel, Strunz and Lehmann 2014, 181)
 - If using RES policies increase potential of making climate policy more stringent than warranted
 - carbon price resistance may justify additional tools
- 5. Move towards carbon markets may be essential in **building coalitions** (financial interests and sunrise industries) that lead to ‘virtuous feedback cycle’ (Paterson 2012)
 - Different context Acemoglu (2013) argues that a minimum wage should be judged also for its political implications (strong trade unions democratize politics)

CONCLUSIONS

- The public choice and political economy literature on climate change is still very much at an early stage though its breadth is far greater than indicated in this discussion
- Though the literature has gone some way in providing explanations of climate policy much less work has been done on considering the implications of political economy analysis for climate policy design