Economics and climate policy: It could go like this

Climate policy needs to be better thought through economically, otherwise it will not work well enough

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Now Europe is starting. The EU under Ursula von der Leyen wants to create the "first climate-neutral continent in the world". A wealth of innovations in the energy industry, construction industry, industry and transport should lead there. Europe is also a continent of climate policy contradictions. For example, exemptions were repeatedly allowed for climate protection targets - as a rule, especially for the major environmental offenders from industry. Large declarations of intent go hand in hand with new coal-fired power plants that make these declarations absurd. And while Germany advocates climate transition, its CO_2 emissions per citizen are much higher than those of France, and the German government keeps protecting domestic car manufacturers from overly ambitious emissions limits from Brussels.

So how do you make the goal of the new "Green Deal" in Europe realistic so that, at least as promised in the Paris Agreement, the climate in 2050 is no longer affected?

The answer: You need an economic policy in which the individual elements fit together and are thought and planned together. And above all, you need a lot of money, especially from the State. So that, as has often been the case in Germany, climate targets are not set - and then missed. In 2020, 40 percent of CO2 should have been reduced compared to 1990, but only 32 percent was achieved.

One reason for this is that economic policy influence on the climate has so far not been completely implemented. Two rough instruments are particularly relevant in practice. Firstly, the so-called pricing of CO2 emissions. This happens through emissions trading, through taxes and requirements that make climate emissions more expensive. There are also large investments in the promotion of renewable energies and in infrastructure and technology for climate protection.

Obviously, that's not enough. The politicians could have known better. After all, economists have long since made several proposals on how to shape climate-oriented economic policies. On the opposite side, researchers from The New School University in New York present important ideas and small improvements in previous policies that could have a big impact. Some have already proven themselves in some places in the world, others are new. Politicians could apply them immediately.

But picking out one or two solutions like a buffet doesn't work so much. Many economic researchers and organizations such as the International Monetary Fund and the World Bank are now arguing that only the simultaneous use of such instruments can achieve the desired goals of climate policy. They must be used in combination so that they reinforce each other and do not fail.

The example of emissions trading, which has been widely used in the EU since 2005, shows why this is important. Roughly simplified, several authorization certificates are issued. Whoever buys a certificate acquires the right to blow a certain amount of CO_2 into the air. These certificates can be traded like securities. This is a solution conceived by economists that promises efficiency: wherever buying and selling is possible - where markets and prices come into play - the thesis is that the resources are used in such a way that they bring the greatest benefit. But if you look at several climate policy instruments together, this solution appears less efficient. In the markets for the certificates, the prices fluctuate from week to week even more extremely than on the stock exchange. Relatively few companies have so far been involved in regular purchases and sales, and from the perspective of these companies, the price of their CO_2 emissions is therefore difficult to define. This flurries any security planning for your own green investments. Should you invest in a modern exhaust system? The decision also depends on what it would cost in the future not to do so.

A direct tax on CO_2 would probably lead to green investments more reliably. But this instrument should not be viewed in isolation either.

The European green deal has a big advantage. It is planned for a whole world region across borders. This is always more promising than national approaches, which are sometimes contradictory. This is based, among other things, on the insight that efforts to coordinate climate policy internationally, such as the Kyoto Protocol, have failed due to national ego trips in recent years.

The most important international climate agreement today, the Paris Agreement, does not coordinate across borders. While recommendations are made there, the countries set their own climate goals and the individual economic policy measures remain in the hands of their national politicians.

To ensure that this can still work without just a few well-meaning isolated solutions in the world, the individual economic policy instruments must be checked for additional criteria: can international cooperation be created for this? Does this instrument even have certain characteristics that encourage other countries to emulate it? Does it bring advantages for willing neighbors?

Anyone who analyzes this in detail will quickly notice that the choice of the right instruments is complicated, contradictory and full of conflicting goals.

The CO_2 tax had just appeared in this text as the means of choice for more green investments. But with a view to international cooperation, CO_2 taxes do poorly. A country that levies CO_2 taxes places a burden on domestic companies compared to its competitors from abroad. Such a country does something for the global climate, but it also creates incentives for other countries to act as free riders: by benefiting from the better climate, but not raising CO_2 taxes themselves and thus giving their own companies a cost advantage. Many economists therefore recommend a CO_2 import tax: if goods or services are imported from abroad without the tax, the difference at the border is retained as customs duty. But decades of commercial policy experience show that those who do something like this cause great trouble. Trade conflicts, which are already rampant these days, are further intensified.

There is only one recommendation here: first think integrated, then act. You should understand the interaction of possible policy prescriptions, and packages have to be put together from the appropriate rules and agreed across borders and markets.

An example: It might happen that a CO_2 import tax makes trading partners angry. But what if a country issues green bonds at the same time and makes them available to cooperative trading partners as a safe investment opportunity? What if this country exports climate-friendly technology and combines it with subsidized green export credits?

Such "package deals" have been common in trade policy for decades and must also be in international climate policy. If the climate is to be protected, economic politicians and the economists who advise them will soon have a lot to do.

BEHIND THE REPORT

"Climate Economics" was developed at the New School for Social Research in New York, a private university with a politically progressive focus. Researchers investigate climate policy instruments from various aspects of the economy - from macro, environmental economics, industrial organization, game theory to financial market theory. Here they present what they are currently recommending to climate politicians.