

The Political Economy of Climate Change Policy: From Idle Speculation to Sobering Experience

Peter Dorman

Evergreen State College

Dec. 2, 2008

Summary of the Argument

- 1. Policy will require massive economic change.**
- 2. There will be big winners and losers.**
- 3. It is possible to design policies that are economically rational and environmentally effective.**
- 4. But powerful economic interests will attempt to take hold of the policy process.**
- 5. This is illustrated by the Western Climate Initiative.**

Roadmap for the Talk

- 1. WCI and its peculiar “economic analysis”**
- 2. The political economy perspective**
- 3. WCI as a political economic episode**
- 4. What should we learn from this?**

The WCI Economic Analysis

The handoff: ICF International and ENERGY 2020

The proprietary model problem

Mysteries of the algorithm

Energy efficiency gap?

Temporary vs permanent price changes?

Innovation?

Intermediate vs final outputs

Costs, benefits and transfers

Reliability

Summary Economic Analysis

Table B-19: Cap-and-Trade Cases Cost Results: Eight WCI Partners

Annualized Costs in 2020 (M\$/Yr)	Broad, Comp Policies No Offsets	Broad, Comp Policies With Offsets	Narrow, Comp Policies With Offsets
	Diff from Reference	Diff from Reference	Diff from Reference
Sector			
Residential	(6,443)	(6,158)	(3,327)
Commercial	(7,845)	(7,369)	(4,760)
Energy Intensive Industry	10,935	10,908	12,674
Other Industry	1,979	1,996	3,250
Passenger Transportation	(20,988)	(20,511)	(19,005)
Freight Transportation	(722)	(522)	0
Agriculture	(442)	(425)	(254)
Total	(23,525)	(22,080)	(11,422)

These costs do not include costs of VMT Reduction programs, Energy Efficiency programs, nor Potential Allowance Value.

A Political Economy Perspective

Enormous economic impact of policy

Rational policy process can be suborned

Examples

Health insurance

Farm subsidies

Ethanol subsidies in particular

At least an order of magnitude difference in economic impacts

Opportunities for Rent-Seeking

- 1. Setting the cap targets**
- 2. Scope of the cap; differential permit budgets**
- 3. Loopholes**
 - off-ramps and price ceilings**
 - offsets**
- 4. Percent of permits auctioned**
- 5. Disbursement of the auction revenue stream**

Lessons from the Western Climate Initiative

A dress rehearsal for federal policy?

Process

Who are the stakeholders?

Transparency

Product

Separate permit budgets for each sector

Permit auctions, minimum 10-25%

Wide discretion in revenue allocation

Up to 49% of reductions can be offset

Summary Economic Analysis

Table B-19: Cap-and-Trade Cases Cost Results: Eight WCI Partners

Annualized Costs in 2020 (M\$/Yr)	Broad, Comp Policies No Offsets	Broad, Comp Policies With Offsets	Narrow, Comp Policies With Offsets
	Diff from Reference	Diff from Reference	Diff from Reference
Sector			
Residential	(6,443)	(6,158)	(3,327)
Commercial	(7,845)	(7,369)	(4,760)
Energy Intensive Industry	10,935	10,908	12,674
Other Industry	1,979	1,996	3,250
Passenger Transportation	(20,988)	(20,511)	(19,005)
Freight Transportation	(722)	(522)	0
Agriculture	(442)	(425)	(254)
Total	(23,525)	(22,080)	(11,422)

These costs do not include costs of VMT Reduction programs, Energy Efficiency programs, nor Potential Allowance Value.

Outline of a Rational Program

Carbon cap-and-trade system

comprehensive and upstream

minimal loopholes

auctioned permits

revenue recycling

Supplemental programs

R&D

infrastructure

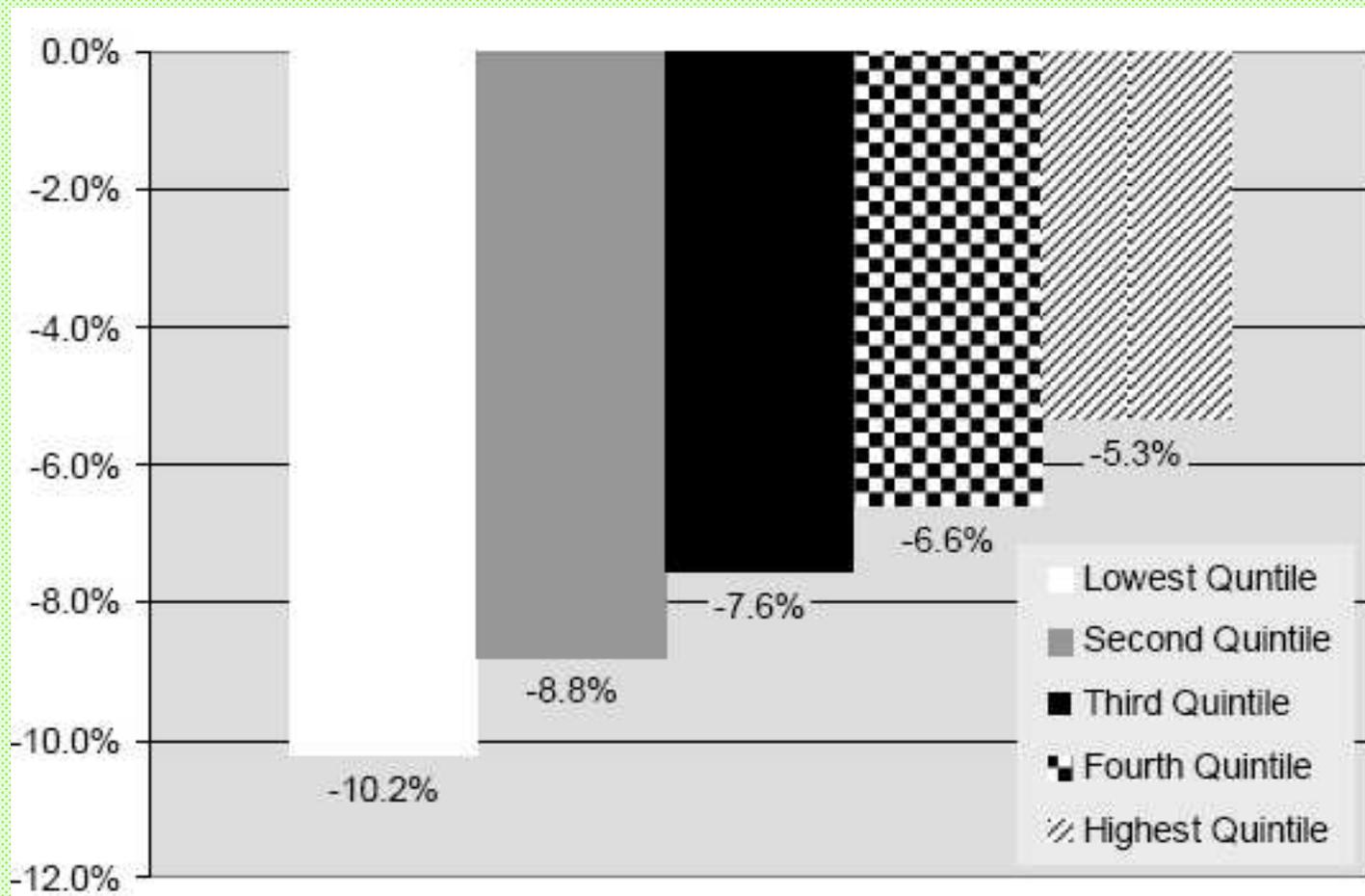
regulation

border taxes

The Importance of Revenue Recycling

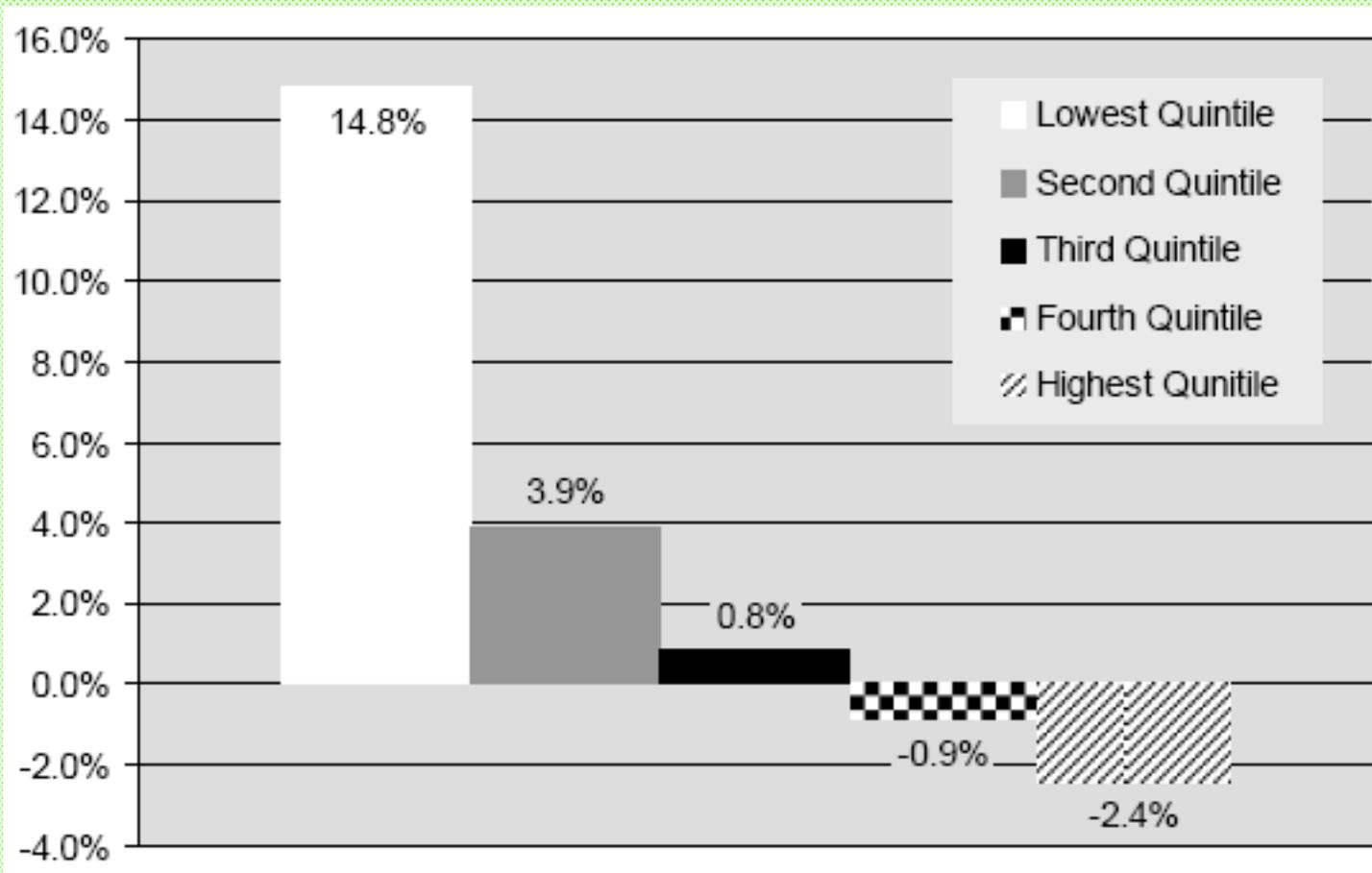
- 1. Macroeconomic considerations**
- 2. Distributional considerations**
- 3. Economic welfare considerations**
 - protect household income**
 - ensure policy sustainability**

Household Impacts without Revenue Recycling



Source: Boyce and Riddle (2007)

Household Impacts with Revenue Recycling



Source: Boyce and Riddle (2007)

Bottom Lines

Reframe the policy debate: this is about economics.

Anticipate manipulation of the process.

Good process is good policy: take the money off the table.

Good policy can work even in an economic downturn.