

On the Inefficiency of Energy and Environmental Policy



Robert Hahn

Professor of Economics and Director of SCI, Manchester
Senior Fellow, Georgetown Center for Business and Public Policy
Senior Visiting Fellow, Smith School, Oxford

Conference at RPI, Oxford
September 14, 2010

Basic Points

- Politics frequently trumps sensible energy and environmental policy (e.g., ethanol)
- The record on policy interventions is mixed from an efficiency perspective
- Sometimes economists' "ideas have consequences"
- Climate change really is the "granddaddy of all public goods problems" – so don't expect too much in terms of mitigation

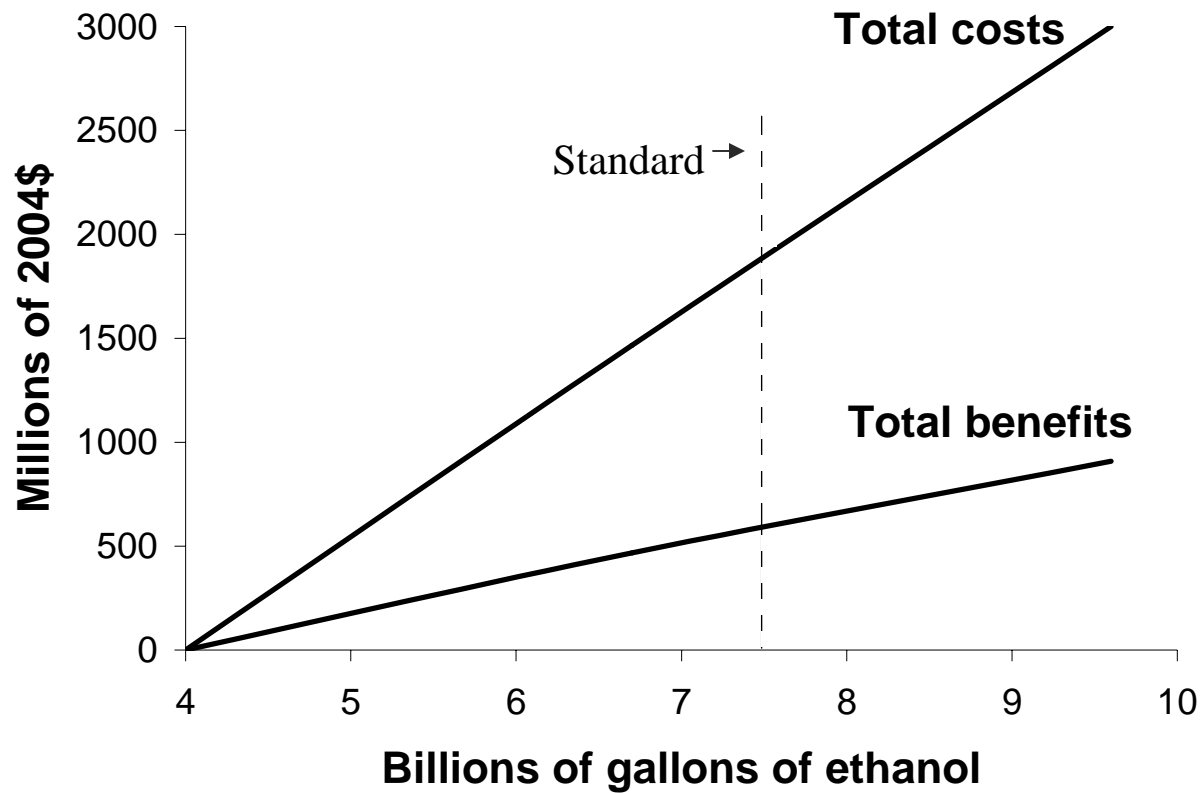
Roadmap

- Provide some thoughts on alternative fuels – as a way of introducing the importance of politics and economics
- Present some economic data on various energy and environmental policies
- Weigh in on U.S. energy and climate policy
- Offer some tentative conclusions about what the future might bring

Ethanol: More Politics

- U.S. Government passes a renewable fuel standard to increase ethanol production
- Government fails to fully analyze the problem, perhaps because of politics

Costs Exceed Benefits in Base Case

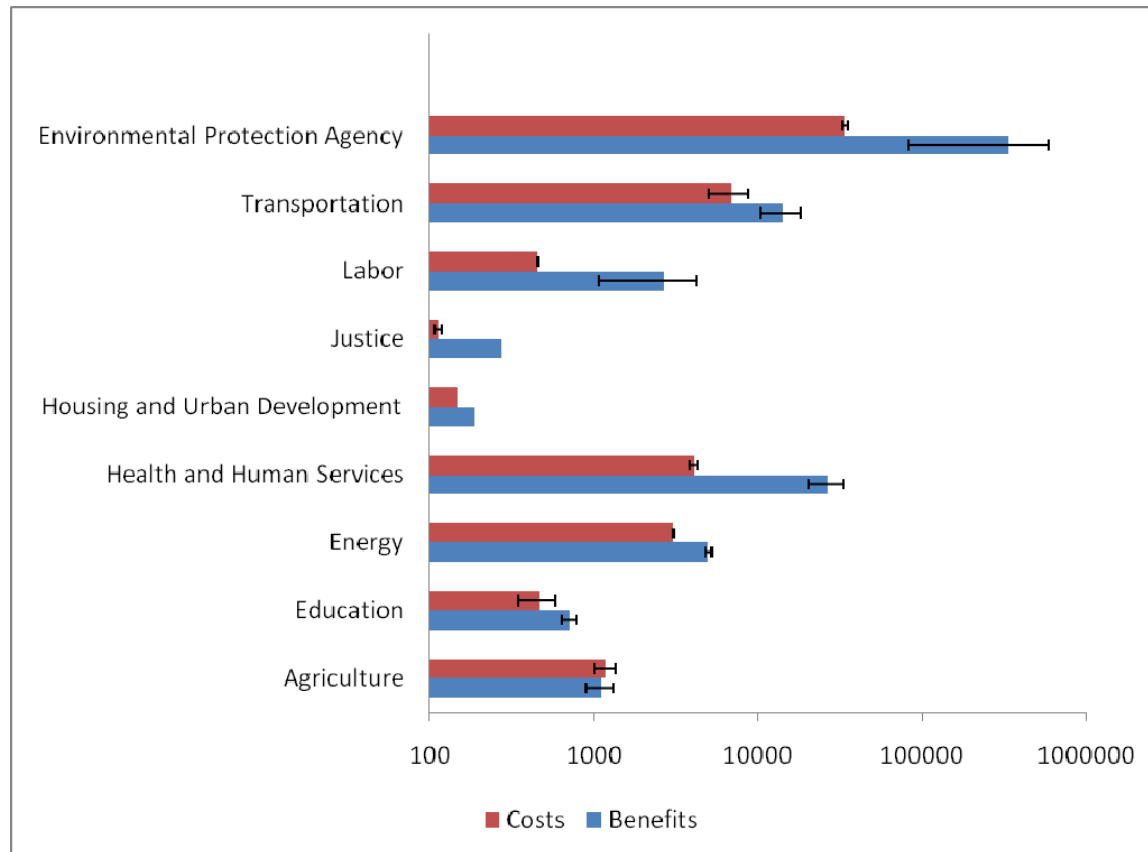


Source: Hahn and Cecot (2008)

More Aggregate Data

- Some energy and environmental regs pass a B-C test
- Economic incentives have the potential to save money and some have, with help from economists
- Subsidies appear to be omnipresent in energy policy

Annual B and C of Fed Regulations



Source: OMB (2008)

Notes: For 1997-2007, Total, Range denoted with error bars, log scale, starts at \$100m

Conclusion: B>C for EPA and DOE; does not say anything about individual regs

Markets: Emissions trading and lead trading

Program	Cost Savings
Lead Phase out	\$200 million between 1985 and 1987 (1985 dollars)
Emissions Trading air pollution	\$1.4b - \$19b (2008 dollars)

Environmental quality objectives largely met

Source: EPA, Hahn and Hester

Some general lessons

- Programs exhibit a wide range of performance on environmental quality and cost savings
- Programs are likely to be more successful if there is more agreement about the underlying distribution of property rights
- Programs raise some difficult issues when regulated entities are major players
- Being able to distribute permits is a big deal for politicians
- We should avoid the temptation to “take a fast train to the wrong station” – e.g., ethanol credits
- We should pay attention to how revenues get used

Subsidies – some observations

- Like it or not, subsidies will be around for awhile
- Removing them could promote efficiency in some cases
- More research is needed to figure out impact of subsidy removal
- Fiscal pressures may push governments in a more efficient direction

Energy Politics and U.S. Climate Change Policy

- U.S. “energy independence” is still a mirage
 - Imports 35% in 1973 (first oil crisis) and 58% in 2007
 - Political will is lacking: “in the year 1980, the United States will not be dependent on any other country for the energy we need” – President Nixon (1974)
- Climate change policy: perhaps a mirage
 - Key Impediments: Costs now, benefits much later; getting cooperation
 - Political will ... ? “In concert with other nations, we simply must halt global warming” – President Clinton (1993)

Conclusion

- Energy and environmental policies will frequently be driven by politics, and thus have “flaws”
- Sometimes analysis can make a difference by exposing these flaws, but it is difficult to say when
 - “quite a lot of cost-benefit analysis is done, but it is sometimes shoddy and politicians often ignore it” - *The Economist*
 - but... sometimes they don't ignore it 😊
- Researchers should take account of likely flaws in designing policies, but also work to reduce them
- Sometimes economists' ideas do have consequences