

On the Inefficiency of Energy and Environmental Policy



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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

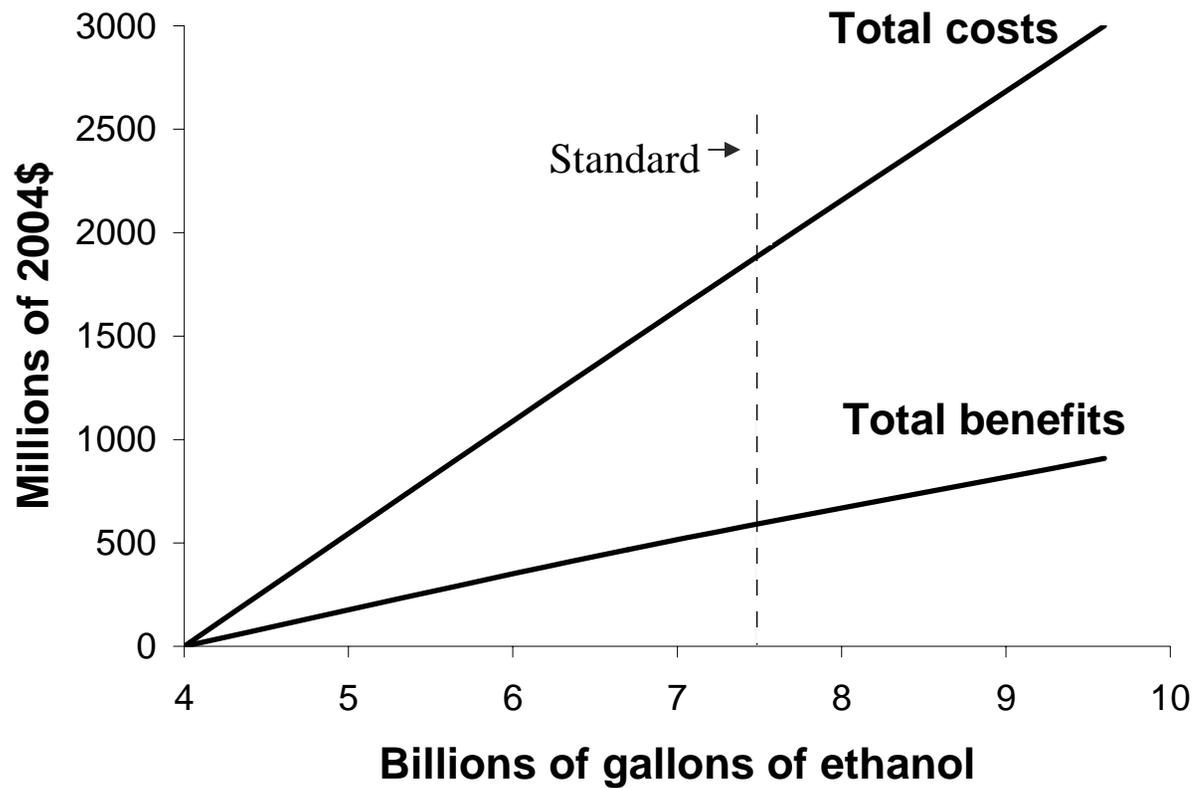
Roadmap

- 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

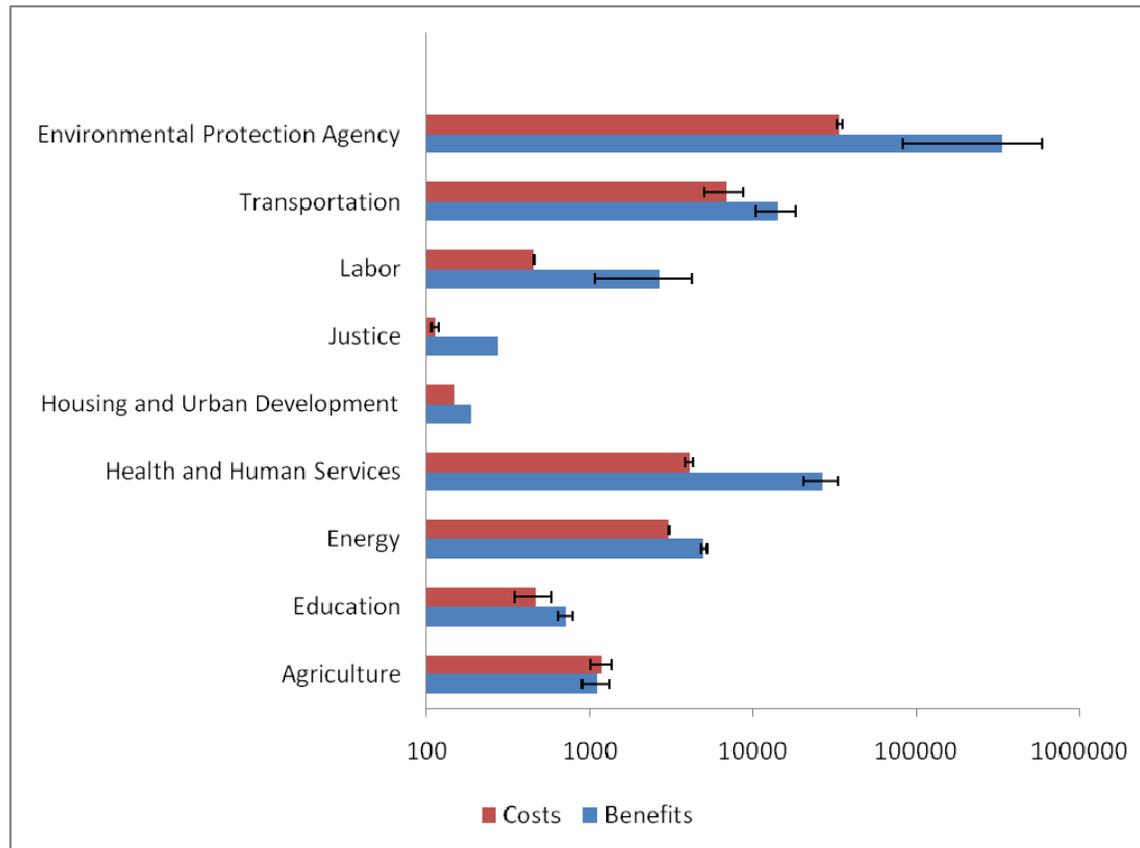


Source: Hahn and Cecot (2008)

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