

ON THE LIMITS OF ENVIRONMENTAL MARKETS – WHY WE HAVE TO TALK NOT ONLY ABOUT ECONOMICS BUT ALSO ABOUT POLITICS

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Overview

Environmental economists have argued for a long time that market-based solutions like certificate trading or a Pigou tax are first best instruments to address environmental policy issues like Global Warming. This is the normative perspective – what ought to be. In a descriptive perspective, the findings are quite different: At a global scale as at the level of single countries like the U.S. and Germany the first-best solutions have not been put into practice. Even it seems that the confidence in market-based approaches is dwindling at many levels – this becomes most evident when comparing the Kyoto protocol of 1997 to the Paris agreement of 2016.

The present contribution explores fundamental reasons behind this setback and implications for energy and environmental economics research.

Methods

This contribution is more conceptual than empirical and it draws on debates between economic thoughts of school as well as broader considerations taken from philosophy and political science.

The key argument to be made is that environmental markets are unlike other markets: First they emerge from well-defined policy objectives and they are therefore (much more) dependent on political decisions to install and shape them. Second and related to the first point: the major strength of open markets to provide a platform and incentives for innovations does not play as much in favour of environmental markets than it does for other markets. This is because environmental policy is helped by directed technological progress (e.g. low-carbon technologies) whereas general welfare is improved by any kind of (valuable) technological (and other) innovations. Third: for environmental markets to function, policies must be time-consistent which requires policy makers to be capable of making self-binding decisions. The latter cannot be secured by any democratic lawmaking procedure but only by a coherent practice that has to emerge over years – but has not emerged so far.

Results

We underpin our argumentation by examples taken from German, UK, European, US and international energy and climate policy, e.g. on carbon floor pricing, certificate trading and certificate caps, renewable energy obligations in buildings or coal phase out. These are illustrative case studies rather than rigorous empirical investigations.

Conclusions

There are four preliminary conclusions to the investigations:

First: besides the question of optimal or first-best policies, also questions of politics and polity matter – since environmental economics is always also environmental policy we need to consider all three dimensions of policy making (cf. e.g. Heidenheimer 1986, Jessop 2015).

Second: a sound theoretical framing is to be combined with pragmatism when it comes to evaluating proposals of practical policies. Those will almost certainly fall behind our theoretical first-best options – to quite some extent because reality is more complex than any economic model. One major complication of real world compared to many theoretical concepts is that we have a multi-level governance structure and not a single global or national government.

Third: environmental policy is always also a debate about the priority to be given to environmental objectives. Environmental and energy economists eager to get their ideas put into practice need not only to participate in that debate but they need to find allies and build coalitions to better policy outcomes – even if they lag behind our theoretical optima.

Fourth: Economists and political scientists may envisage a new research agenda on methods and tools that help policy makers to identify and find good compromises instead of being subject only to pressure by multiple interest groups.

References

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