

Freeing the Market to Address Climate Change

by Jason Scorse

We know what we need to do to mitigate climate change; we have for decades. The challenge is not one of technology (although we will need to invent new technologies), nor is it one of workable policy options. In fact, the best way to address climate change would be through one of the simplest measures imaginable: an annually escalating greenhouse gas tax on all sources of energy.

But the simplest solution turns out to be the least feasible, because the barriers to addressing climate change are almost entirely political. The special interests that stand to lose as fossil fuel becomes increasingly expensive, and is ultimately phased out, are extremely adept at sowing public confusion, paying off politicians, and warning that our economy will collapse if we enact policies to address climate change.

As an economist, I spend a lot of time thinking about the subtle details of policies—the unintended consequences, the trade-offs between efficiency and equity, and how best to spur innovation—but from the standpoint of the environmentalist movement, which is concerned with actually getting laws passed, these details are largely irrelevant. The key issue is how to overcome the power of the special interests, especially the oil, coal, and gas lobbies.

Ironically, the international institution that is probably best positioned to take on these special interests is the World Trade Organization (WTO), which has often been vilified by the environmental community and the Left in general.

The WTO, which was founded in 1995 as a continuation of the General Agreement on Tariffs and Trade (GATT, signed in 1947), is tasked with liberalizing international trade. The primary means of promoting freer trade are reducing trade barriers—primarily tariffs and quotas—and reducing export and production subsidies that distort the world prices of goods and services. It is by focusing on subsidies that the WTO can play an incredibly constructive role in addressing climate change (and other forms of environmental degradation).

So-called “[perverse subsidies](#),” which promote activities with significant negative externalities, include almost all of the natural resource subsidies undertaken by governments around the world: subsidies for fossil fuels, water, forestry, agriculture, and fishing. While measuring these perverse subsidies precisely is extremely difficult, estimates range in the hundreds of billions to trillions of dollars a year ([Kent and Myers 2001](#)). Put bluntly, this is real money with tremendous impacts.

If governments continue to subsidize environmental degradation and dependence on fossil fuel to this degree every year, all environmental efforts, no matter how noble, will always be akin to using a cup to bail out a sinking ship. Attacking these perverse subsidies and eliminating them should be the top priority for the environmental community; they are one of the root causes of most environmental problems.

The WTO's explicit mandate is to eliminate these subsidies. The problem with the WTO is not that it caters to corporate interests, but that it has not yet lived up to its promise because it can only be as consistent as its member states, which are often at the mercy of various forms of entrenched and parochial interests.

Before the collapse of the WTO Doha Round in 2006, [the proposal](#) called for the elimination of all agricultural export subsidies by 2013 and cuts of 50–75 percent in the most trade-distorting (and hence harmful to farmers in developing countries) agricultural production subsidies in the EU, U.S., and Japan. The developed countries were willing to make this commitment because of the prospect of greater market access in the developing world. While many developing countries, notably India, Brazil, and China, did not think the promised subsidy reductions were sufficient to warrant greatly reducing their agricultural tariffs and thus exposing their farmers to greater international competition, the agreement marked the greatest multilateral cuts to agricultural subsidies that had ever been proposed.

With the [world food price index](#) having risen by more than 30 percent since 2006, the need for domestic agricultural subsidies has decreased; therefore, there is now the potential for greater reductions from OECD nations, who desperately want to take advantage of rising consumer demand in emerging markets since domestic demand at home remains anemic. (As a side note, New Zealand is the first OECD country to unilaterally eliminate its agricultural subsidies, and agriculture remains New Zealand's major export industry.)

In addition to progress on agricultural subsidies during the Doha Round, progress has also been made on an agreement to address [global fisheries subsidies](#), which are wreaking havoc on the marine environment by promoting over-fishing—often by foreign fleets at the expense of local fishermen. WTO working groups have agreed on the basic structure for defining the types of fishing subsidies that would be banned, along with exemptions for the least-developed countries and new efforts toward global monitoring of fish stocks.

With the Obama Administration committed to revitalizing the Doha Round, it is imperative that environmental groups insist that all forms of perverse subsidies, especially for fossil fuels, be included in the negotiations. Some may counter that if individual nations have found it politically impossible to remove these forms of subsidies, why would we expect the multilateral community to fare any better? And why would the Obama Administration want to delve into this politically treacherous territory?

One of the main reasons it is difficult for an individual nation to take on its entrenched interests is that opponents can argue that if these special breaks are taken away, the affected industry will be at a competitive disadvantage with respect to countries that maintain government financial support. There is a strong aversion to being a first-mover in any global effort to reduce perverse subsidies.

This is why the WTO framework is so crucial; all countries can agree to unwind their subsidies together, at a measured pace, giving leeway to countries that may suffer above-average employment impacts. By getting everyone to agree to coordinated action, the competitive

pressures are greatly reduced, and any individual members who flaunt the rules face the very real possibility of retaliatory action—and the WTO is one of the only international bodies with serious enforcement powers to back up its agreements.

While it is true that there has yet to be a multilateral effort aimed at reducing energy subsidies, the [existing WTO framework has provisions with which to address the issue](#). If progress could be made on agricultural and fisheries subsidies, this could generate the momentum necessary to expand into energy issues, especially now that climate change is front and center on the international agenda. With energy companies reaping record profits, federal deficits at record highs, and the recent mining disasters in West Virginia and the BP oil spill in the Gulf of Mexico, the political climate in the U.S. couldn't be more favorable for putting energy subsidies on the table.

Focusing on the elimination of various forms of perverse subsidies has the added benefit of freeing up tremendous amounts of financial resources. Given the global financial crisis and the precarious fiscal situation among most of the OECD countries, it is an open question how climate mitigation and adaptation projects in the developing countries will be funded. In Copenhagen last December, an annual \$100 billion fund was proposed, but no one knows where this money will come from. Ending perverse subsidies would make available hundreds of billions of dollars, part of which could be directed to these efforts. In fact, it is not inconceivable that agreements could be made to specifically direct reductions in subsidy payments for fossil fuels, agriculture, or fisheries into a global climate change fund.

A natural consequence of the elimination of perverse subsidies would be an increase in the market price for energy and natural resource-intensive goods and services, thereby creating incentives for greater efficiency as well as shifting consumption patterns. Environmentalists speak of the need for paradigm shifts in the goods we produce and consume, and there is no better mechanism that could serve as a catalyst for this transformation than removing the huge distortions in current market prices caused by perverse subsidies.

Many environmentalists argue that the structural biases against investments in alternative energy justify subsidies for solar, wind, geothermal, certain biofuels, and other potentially less greenhouse gas-intensive energy sources. While these “green” subsidies promote cleaner alternatives and are responsible for the rapid growth in renewable energy in many parts of the country, they carry a hidden cost as well.

By promoting particular technologies, the government creates new biases against nascent technologies that have yet to make it to the commercial phase. It is likely that the optimum energy mix from an environmental standpoint in 2050 or 2100 will include technologies that have yet to be invented, and the last thing we want is for the government to discourage risk-taking and lock in certain technologies too early on, even ones that on most dimensions appear superior to the status quo.

Once perverse subsidies are greatly reduced, it is best if governments shift their attention to investing in basic research and development that is valuable across many types of technologies

and can lead to the widest possible spectrum of outcomes. This is why, ultimately, all technology-specific subsidies should be phased out.

As with all recommendations, what I have laid out is infinitely easier said than done. But it is possible if the environmental community takes the issue seriously and devotes resources to getting these issues on the political agenda much more forcefully. This would include:

1. Devoting staff to regularly documenting and measuring perverse subsidies
2. Keeping membership regularly abreast of the issue through newsletters and email communiqués; making sure it is on the collective radar all the time
3. Devoting significant website presence to perverse subsidies; putting the issue front and center
4. Educating politicians and their staff about the issue so that they are armed with the statistics and the environmental impacts
5. Lobbying hard for the elimination of perverse subsidies at every level—state, national, and international
6. Calling for the resumption of the Doha Round, with a new emphasis on environmental issues to complement the development focus. Given the latest round of climate change talks, this could be a natural selling point to merge the two issues on the international stage.
7. Last, but perhaps most importantly, changing the tone within the environmental community that often perceives markets and economics as antithetical to environmental interests. We must shift the terms of the debate so that environmentalists are arguing in favor of freer markets, free of handouts to special interests that distort market prices and discourage efficiency and innovation.