

## Global warming policy

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Warwick McKibbin and Peter Wilcoxon (Spring 2002, p. 107-129) argue that the Kyoto Protocol is “deeply flawed” and present their own alternative regime for an efficient international climate policy. However, if one looks more closely at McKibbin’s/Wilcoxon’s alternative, it becomes very clear that it would suffer from at least as many flaws as the Kyoto Protocol.

Their main argument against the Kyoto Protocol is that a tax is better than a permit system, based on the slopes of the marginal cost curves as argued by Weitzman (1974). However, the fight between proponents of a quantity-based and a price-based climate policy is as old as climate policy itself. It is by no means certain that the marginal benefit curve of emissions reduction is flat. If one factors in possible “nasty surprises” such as shutting down of the gulf stream or collapse of monsoon circulation, the benefit curve may be much steeper than originally thought. And likewise, the marginal abatement cost curve may be much flatter than thought if backstop technologies suddenly emerge. Apart from this controversy, shapes of the curves can change over time. Newell and Pizer (2000) argue that the slope of the cost curve is likely to decline while the benefit curve becomes steeper. Thus, the jury is still out here.

To remedy the “flaws”, McKibbin and Wilcoxon suggest a hybrid system, consisting of long- and short-term permits. However, fixing the quantity of the long-term permits is absolutely analogous to fixing a quantitative emissions target under the Kyoto Protocol. The short-term permits issued at a fixed price in whatever quantity needed are nothing else than a “price cap”, i.e. a safety valve to prevent that spikes in the international permit market create economic hardships. Müller et al. (2001) have analysed the functioning of such a price cap and found that it creates more problems than it solves.

A price cap can be set on either on a national or international level. The former would mean that emissions trading between countries would become impossible due to arbitrage – all permits would flow out from the country with the lowest price cap as long as the cap is binding. The country would earn rents from the printing of permits. The international permit price would decline to this value – bad money drives out the good – and a larger number of additional permits enters circulation. Pizer (1999, p. 9) therefore suggested forbidding permit sales from countries with lower price caps.

Setting the price cap on an international level is a political nightmare, especially under the consensus principle. Negotiating floor prices in the context of international commodity agreements has been very difficult and agreement could not be sustained for longer periods (ODI 1995). If the price cap is set on an international level, the question remains of who controls emission of permits if the price reaches the threshold. Central issuance would guarantee that there is a common procedure and currency used. If we leave the allocation to the discretion of governments, the question arises as to how the cap is converted into national currencies. Some countries would use exchange rates, others would argue for purchasing power parities. In case of exchange rate fluctuations arbitrage possibilities arise.

After setting out their scheme, McKibbin and Wilcoxon’s criticise the Kyoto Protocol for being costly without achieving significant benefits; they quote some general equilibrium modellers’ cost figures. Whether general equilibrium models are the appropriate instruments to evaluate costs of climate policy remains doubtful; there are also many bottom-up energy models around that come to completely different conclusions (see e.g. Bernow et al. 1999). But if the general equilibrium modellers are right, I do not see how McKibbin’s and Wilcoxon’s strategy would achieve a better cost-benefit ratio than the Kyoto Protocol.

A last issue McKibbin and Wilcoxon attack is the international trade in permits through the Kyoto Mechanisms. They just argue that the resulting transfer in wealth to developing countries would make sure that the Protocol would never be implemented by the US. I would argue that the US currently transfers much larger amounts to developing countries to get a steady flow of raw materials such as oil. International trade in permits is *the* necessary condition to achieve a cost-efficient climate policy. Otherwise, we will never get near an equalisation of marginal costs.

All in all, I would argue that McKibbin's and Wilcoxon's proposal is at least as "impractical policy" as the Kyoto Protocol. The Protocol has enough pathways to allow an increasingly global and efficient climate policy. Thus and due to its innovative institutional features it is the only game in town. Instead of suggesting "alternatives", economists should concentrate on convincing policymakers how to get the long-term climate policy instruments right that build on Kyoto's foundations.

Axel Michaelowa  
Programme "International Climate Policy"  
Hamburg Institute of International Economics  
Germany

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