The Political Economy of Carbon Policy

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Agenda: The Interplay Between Economics and Political Economy in Carbon Policy

A simple model of the relationship between policy design and the policy process

Two examples from the past

Carbon policy from a political economic perspective
Assumptions of the Model

1. Policy space: an ordered, bounded set
2. Policy process an the MEI
3. Private versus public interest
A Simple Political Economy Model
Restrictive model: initiate policy process at $P_0 < P^*$

General model: truncate the policy space through precommitment

Both: measures to increase the slope of MEI

“good government”

competition for influence
Remember This?

Presidents Plan Page 66
The Health Insurance Debate of 1993: A Cautionary Tale

Clinton’s mandate
The insurance industry fights back and defeats proposal

Analytical notes:
placement of $P_0$ failed
absence of competition
Social Security: Dodging the Bullet

Principal domestic priority for Bush after 2004
Defeated through large-scale mobilization
Analytical notes:
  full privatization removed preemptively
  substantial competition for finance lobby
Carbon Policy: Where’s the Money?

1. Setting the cap targets
2. Scope of the cap; differential permit budgets
3. Loopholes
   - off-ramps and price ceilings
   - offsets
4. Percent of permits auctioned
5. Disbursement of the auction revenue stream
Outline of a Rational Program

- comprehensive and upstream
- minimal loopholes
- auctioned permits
- revenue recycling
- mirror opposite of private interests
The Western Climate Initiative
The WCI Process

- Stakeholder input
- Economic analysis
- Design recommendations (Sept. 23)
- State and provincial response
The WCI Product

Emissions goal: 15% reduction from 2005 levels by 2020

Design recommendations:
- Separate permit budgets for each sector
- Permit auctions, minimum 10-25%
- Wide discretion in revenue allocation
- Up to 49% of reductions can be offset
### Who are the stakeholders?

### What is the stake?
A Political Economy Perspective on the WCI

Main WCI goal: obtaining business buy-in
So it offered the full range of lucrative policy options….
And devised a “bad government” process of industry stakeholder consultation.
Meanwhile, there was no competitive mobilization.
A Cautionary Pair of Numbers

Est. profits in health insurance, 2007:
$12.6B

Est. start-up value of carbon permits:
$300B