

POLICY NOTE

The environment and economy suffer when public officials hide from accountability

By Todd Myers, Director, Center for the Environment

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Key Findings

1. Subsidies and regulation assume politicians and bureaucrats know what approaches will cut pollution. There are several problems with this.
2. Regulations add hidden costs, thus protecting politicians from accountability.
3. Officials promise lofty environmental goals, then consistently miss their own targets.
4. Public policy can use markets to efficiently show people the true cost of using resources.
5. Research shows people are price-sensitive and adjust their behavior to reduce environmental impact.
6. A truly market-based approach respects individual freedom, and moves away from regulations and subsidies, replacing them with policies that give consumers more power.

Introduction

There is a climate consensus growing in Olympia, and both Republicans and Democrats seem to agree.

Senator Reuven Carlyle, new chair of the Energy, Environment and Technology committee, argues the state must subsidize a wide range of government projects and create regulation to force CO2 emission reductions. He told *The Seattle Times* that increasing a price on pollution doesn't work, claiming the previous revenue-neutral carbon tax proposal, Initiative 732, "relied on the price signal...and myself and many others don't believe that works. What works is how you deploy those dollars."¹

Senate Republicans seemed to agree that using price signals doesn't work. They tweeted out:

"If Dems want to reduce carbon for the sake of the planet, regulation reform would be the way to go. Energy tax SB6203, would just drive companies out of WA to less-regulated areas with a friendlier tax structure. Reform to reduce carbon. Don't tax."

Policy and regulation are key

Republicans and Democrats both argue that pricing pollution is not the way to go. They say policy and regulation are the key, although they disagree about whether it should involve carrots or sticks. While both examples are about CO2 emissions, the principle could be applied to any pollution – air pollution, water pollution, etc.

It should also be added that the argument about whether a particular environmental problem is significant is a different question than the one I am addressing. Many on the right argue that climate change and other environmental issues are exaggerated in an effort to justify more government programs.

This is a legitimate complaint and I have watched environmental activists undermine effective policies simply because they did not have a government power component. There are, however, many real

1 Podcast: State Sen. Reuven Carlyle on 'punitive' property tax boost about to hit Seattle," by Jim Brunner and Daniel Beekman, *The Seattle Times*, February 2, 2018, at <https://www.seattletimes.com/seattle-news/politics/podcast-state-sen-reuven-carlyle-on-punitive-property-tax-boost-about-to-hit-seattle/>.

environmental problems and the question is whether we should put our faith in politicians or in personal incentives to address them.

Do political decisions about spending and regulation do a better job in helping protect the environment than pricing pollution? The answer is pretty clearly, “No.”

First, do subsidies and regulations work? Not very well.

The problem with subsidies and regulations

Subsidies and regulation are premised on the assumption that politicians and bureaucrats can accurately predict what approaches will work to cut pollution. There are several problems with this.

To begin, knowing what works can be difficult. The federal government subsidized corn-based ethanol long after it was clear that doing so might actually increase pollution. Cities ban plastic grocery bags, even as the science indicates they use less energy to make and cause less water pollution than the alternatives. Sometimes, simply knowing what is good is difficult.

With regulation, it is also difficult to assess the cost. This is not an accident. Politicians don’t want constituents to feel the pain imposed by their policies, so they hide the impact in regulation.

That secrecy adds cost. Why add a 10-cent tax that voters will blame on you, when you can pass a regulation that creates a 20-cent price increase and blame the companies? People’s lives are worse, but politicians are protected from accountability.

Benefits of regulation are overstated

Given these higher costs, it becomes difficult to know whether the policies are worth it. Not only are the costs of such policies higher, their benefits are often overstated. Research shows people overestimate the social welfare value of policies designed to “nudge” others in a particular direction.

In a paper for the National Bureau of Economic Research, economists Hunt Allcott and Judd B. Kessler found, “traditional evaluation approaches overstate welfare gains” from one such nudge policy they studied.² This is one small example, but it demonstrates the risk that regulations have higher, hidden costs and lower benefits than projected.

There are many other problems with regulation, but the most compelling evidence is that we often don’t get the results we were promised. Germany’s subsidy and regulation-heavy approach was offered as the model of success in carbon reduction, until that country’s CO2 emissions increased three years in a row.

2 “Welfare Effects of Nudges: A Case Study of Energy Use Social Comparisons,” by Hunt Allcott and Judd B. Kessler, Working Paper 21671, National Bureau of Economic Research, October 2015, at http://assets.wharton.upenn.edu/~juddk/papers/AllcottKessler_WelfareOfNudges.pdf.

Examples of regulation failure

Spain was the most frequently-mentioned model before that, until the country hit 26 percent unemployment and the system collapsed. Seattle has consistently missed its CO2 reduction targets, despite promises by a series of mayors. Snohomish County's biofuel feedstock plant cost millions of taxpayer dollars and never produced anything useful. I could go on.

This is not to say that regulation can't achieve a goal at a high cost. We could ban gas-powered cars tomorrow. It would radically reduce CO2 emissions, but it would come at a completely unacceptable cost.

It also doesn't mean there are not circumstances in which regulation is a good option. Removing lead from gasoline was a simple and transparent way to reduce the amount of lead pollution in the air.

And, it worked well. Such examples, however, are the exception, not the rule.

Taxes can make environmental problems worse

Further, conservatives would argue that taxes can make the problem worse by pushing companies out of the state to places where they will pollute more. This is a risk, but the same is true of overregulation.

Further, while reducing regulation is a good idea and one I support, reducing regulation (or taxes) does not create incentives to cut pollution. Nobody would argue (I think) that trash collection should be free. Nobody would say those who pour pollution into a stream should pay nothing. To the contrary, the free market argues explicitly that you must take responsibility for the impact you have on someone else's property.

So, as an alternative, does pricing pollution work? The obvious answer is "yes." We are very accustomed to paying a price for pollution to safely manage sewage and trash. We pay for resources, like clean water and electricity, and the price goes up as we use more. We pay commensurate to our impact on resources. This is a basic economic principle.

The importance of accurate pricing

Research demonstrates that people are price-sensitive and adjust their behavior in response to these costs and that prices reduce environmental impact.

Researchers Koichiro Ito and Takanori Ida tested the effect of increasing the price of electricity during peak demand to see if people would reduce energy use and how durable³ was the effect. They found, "consumers faced with transparent price information on time-varying pricing respond to marginal prices as standard economic theory predicts."

3 "Moral Suasion and Economic Incentives: Field Experimental Evidence from Energy Demand," by Koichiro Ito, Takanori Ida, and Makoto Tanaka, *American Economic Journal: Economic Policy*, Volume 10, No. 1, February 2018, <https://pubs.aeaweb.org/doi/pdfplus/10.1257/pol.20160093>.

They found that increasing prices, “motivated customers to lower their usage,” and that the effect lasted even when the price changes weren’t there. Once people felt the price of their decisions, they found low-cost ways to adjust their behavior and save energy.

This does not mean we should endorse political manipulation of prices to “nudge” people in a chosen direction that are not accompanied by a clear environmental benefit. The Republican critique of pricing pollution is that it seems artificial – the price is set by politicians who are using taxes as a club to beat people.

Fair enough, but that is the problem of setting the price to match the costs of pollution, not the validity of pricing. Indeed, in their study, Ito and Ida reflected the real-world cost of producing energy at peak demand – not an artificially inflated price.

The moral benefit of price signals

Price signals are effective, and they have the added moral benefit that they are more respectful of individual choice. Prices allow people to choose their own behavior and either to pay the price or avoid pollution in a way that suits them personally. Regulations don’t do that – government officials make the decision for you and remove any choice.

Consider the difference between putting a price on plastic grocery bags and simply banning them. I have dogs. I need plastic bags and am going to pay for them one way or the other, so banning them does not reduce my environmental impact. It just makes my life more difficult for no environmental benefit (and probably increased environmental harm). I am, however, willing to pay for the bags, plastic or otherwise, that I throw in the garbage.

Pricing pollution is not attractive to politicians on the left or right. The left wants to force people to change their lifestyle in particular ways, while keeping the cost hidden and not getting specific on the benefit to the environment. Prices, in this view, leave people with too much choice.

People on the right are skeptical of pollution pricing because they feel taxes are already too high and they see pricing as a way to “nudge” people in a politically preferred direction with no environmental benefit.

As a result, both sides run to the seeming comfort of regulation and government guidance – the left with overt regulation, the right with vague regulation “reform.” That, however, combines the worst of both worlds. Regulation and subsidies give people a political push in a particular direction, either with sticks or carrots.

Conclusion

These political approaches each have their own problems. For the left, regulation often comes with a high cost. What is more, other political priorities intervene, causing regulations to fail. For the right, the combination of skepticism about regulation and the pressure to show action on environmental issues, means they split the baby, offering lower-cost approaches that have low-chances of success.



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A truly market-based approach, one that respects individual freedom while providing incentives to reduce pollution that harms others, moves away from big-government regulation and political subsidies and replaces them with approaches that give consumers more power.

That may be politically difficult, but that difficulty is why putting our faith in politicians to help the environment is a fool's errand and won't work.