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Threats or opportunities? The economics of the government's new carbon targets

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This week the coalition government announced a radical set of climate change targets which will limit the UK's CO_2 emissions to 50% of their 1990 levels by 2025 and shift the emphasis of the UK's energy consumption firmly away from fossil fuels towards renewables and nuclear.

If reports are to be believed, the construction of these targets resulted in considerable disagreement around the negotiating table with a number of key individuals raising concerns about the potential economic impact. These are the political realities of environmental policy-making, particularly within countries whose manufacturing sector is already buckling under the pressure of competition from low-income economies. Those politicians who believe the case for climate change is a little overstated or whose ear has been caught by certain powerful industrial lobbies will inevitably have expressed concerns that a policy of this nature will raise firms' costs, damage their competitiveness and ultimately cost jobs. Perhaps more pertinently, they will have claimed that this is not the right time to further weaken the UK economy just as it takes its first tentative steps towards recovery.

So how might these emissions targets, and the environmental regulations required to achieve them, impact upon the UK economy? Over the last decade or so a body of academic work has examined the impact of environmental regulation costs on industrial competitiveness. If such competitiveness were adversely affected by stringent regulations then we should be able to statistically isolate this effect by examining net trade and/or foreign direct investment patterns between high and low regulation economies, controlling for all other explanatory factors. A large number of studies, including work undertaken at the University of Birmingham, has attempted to do just that but has generally been unable to find clear evidence of any such link. Studies have also examined the impact of regulation costs on employment and productivity levels but have also largely drawn a blank. This large body of work, which has focused on countries such as the UK, US and Japan, therefore provides little grounds for fearing widespread economic impacts from implementing stringent environmental policy.

However, all government policies tend to result in winners and losers and it would be reckless to claim that there will be no losers at all as a result of what is undeniably a bold and ambitious policy. While energy intensive industries will be given concessions to ease their burden, the overall economic impact will be further lessened by allowing an undisclosed proportion of these targets to be met by reducing emissions in other countries, where the cost of controlling pollution may be lower than in the UK. Nevertheless, UK firms will have to do things differently as a result of these targets, particularly those that are relatively energy intensive. There is little doubt that fossil fuels are going to become increasingly expensive in the years ahead whether through scarcity, regulation or both. Firms in the UK have to embrace this change and reap the potential efficiency (and other) benefits of utilising new, cleaner, techniques of production. These targets also provide significant opportunities to the environmental technology industries which are likely to receive unprecedented levels of demand and investment over the coming years. However, in order to make key investment decisions of this nature, firms need to be operating in a clear regulatory environment that is predictable in the medium to long term. It is therefore unfortunate that the new policy contains a get-out clause whereby targets will be reviewed in 2014 to see if our European competitors are adhering to their own carbon targets. Such a clause, no doubt inserted to appease the opponents of the policy, will inevitably introduce regulatory uncertainty which could hamper environmental investment.

This bold policy will therefore create a number of challenges, many of them technological in nature, but need not create the economic turmoil suggested by its critics. Factor in the potential benefits to the environmental technology industries and the filip to international environmental diplomacy resulting from being seen to be putting our own house in order and the policy can be seen as providing far more opportunities than threats.

Matthew Cole
Professor of Environmental Economics

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