EBERHARD KARLS UNIVERSITÄT TÜBINGEN

Wirtschafts- und Sozialwissenschaftliche Fakultät

Lehrstuhl für Volkswirtschaftslehre insbes. Finanzwissenschaft

Prof. Dr. Georg Wamser

Georg Wamser on Carbon Pricing (an event organized by Global Marshall Plan Tübingen and Bürgerlobby Klimaschutz Tübingen, January 27, 2020).

Georg Wamser explains why it makes sense for governments to put a price on carbon emissions, from an economics point of view.

For an economic perspective on climate policy, let us first acknowledge that governments should intervene in the economy if markets fail (i.e., if the market mechanism does not achieve an efficient allocation of resources). In particular, the public finance literature provides convincing arguments to justify government involvement: "[...] the market mechanism alone cannot perform all economic functions. Public policy is needed to guide, correct, and supplement it in certain respects." (Musgrave and Musgrave, 1989).

There is a broad consensus that policy action is needed to fight global warming. To make the case for government intervention, we may distinguish between two basic arguments. First, Stiglitz (2019) reasons that the global environment can be interpreted as a public good: "The fundamental issues are simple to state but hard to resolve: the global environment is a global public good – all benefit from a good environment, and all suffer from climate change. As in the case of any public good, there is a problem of undersupply: everyone would like to 'free ride' off the efforts of others in supplying the public good."

Second, a related, perhaps more intuitive way to justify government action in the context of global warming is based on the fact that fossil fuel burning generates a negative externality. An externality occurs because the emissions of one party make the rest of the world worse off. The costs of climate change are underestimated by the individual as they are borne by many (in fact, in the case of global warming, by all of us).

We may also say that private and social costs diverge. The latter terminology goes back to Pigou (1929). In his seminal work, Pigou suggests that there is often a "[...] divergence between the values at the margin of private and of social net products. The existence of these divergences is bound to lead to maladjustments" (p.95). He continues to argue that governments should correct such externalities by using taxes: "When maladjustments have come about or are threatening to come about, [...], it is always possible to correct them by imposing appropriate rates of tax [...]" (p.99).

Pigou's reasoning is still very powerful and generally implies that governments should put a price on CO2 emissions. Accepting this principle case for government involvement, economic models can further inform policy about the correct "price" on CO2, which ultimately depends on the extent to which private marginal cost diverges from social marginal cost. The latter is, given what we know, quite substantial.