



Policy Mixes: Tradable Permits & Other Instruments

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Background (1)

- Frequent recommendation to use “policy mixes”, however inadequate understanding of economic and environmental consequences of doing so
- Work programme at OECD Environment Directorate to set out main issues - focusing on cases where two (or more) instruments are used to hit approximately the same environmental target in same sector

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Background (2)

- Tradable permits were selected as an initial case study since they are often used in conjunction with other environmental policy instruments
- Report explored the interactions of tradable permits with:
 - Taxes and Charges
 - Direct Regulations
 - Subsidies
 - Voluntary Approaches
 - Other TP Schemes



Overview of Main Findings

- Many countries are in fact presently seeking to “kill one bird with two stones”
- Doing so can be economically inefficient and environmentally ineffective
- However, under certain conditions, a case can be made for the use of policy mixes



Reducing Abatement Cost Uncertainty

- Trade-off between environmental certainty and compliance cost certainty
- Case can be made for the use of mix of permits, taxes (and subsidies) on grounds of social welfare maximisation and political feasibility
- In practice many countries are actually using taxes to cap permit prices, but use of subsidies less prevalent

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Overcoming Technology Market Failures

- Co-existence of two market failures – environmental and technological
- Inadequate supply-side response to cost incentives provided by tradable permit regime
- Use of second instruments to address additional market failure (i.e. support for research and development, research clusters, public-private partnerships)
- Trade-off due to potential for misdirection of trajectory of technological change

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Increasing Behavioural Responsiveness

- Demand-side responses to price incentives may be subject to long lags:
 - Consumption externalities
 - Information failures
 - Policy uncertainty
- Measures to accelerate responsiveness of firms and households (information programmes, demonstration projects, etc...)
- Can increase elasticities, but similar hazards to 'technological' policies.

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Addressing Local Environmental Impacts

- Tradable permit systems are sub-optimal if the spatial scale of the market includes sources with heterogeneous impacts
- Direct regulations are frequently used to prevent thresholds being exceeded
- Trade-off between abatement cost minimisation and equalisation of marginal costs and benefits of abatement

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Conclusions (1)

- As a general rule – do not kill one bird with two stones
- However, under certain conditions may be efficient and effective to do so
 - Significant abatement cost uncertainty
 - Technological market failures
 - Long lags in behavioural responses
 - Local environmental impacts



Conclusions (2)

- When doing so, must ensure that the “complementary” policy:
 - meets a legitimate policy objective that can not be met more efficiently through the TP system itself
 - is the best instrument available to the regulatory authority to meet that policy objective
 - preserves the economic and environmental benefits of the TP system to the greatest extent possible
 - is administratively feasible at reasonable cost