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BETTER POLICIES FOR BETTER LIVES

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Green growth

ENVIRONMENTAL POLICIES AND PRODUCTIVITY CAN WORK TOGETHER

- Stringent environmental policies can be introduced without hurting overall productivity
- Letting up on environmental policies would not necessarily support a recovery
- The design of environmental policies is key, emphasising the importance of flexible, market-based instruments, such as taxes, in the policy mix
- Sending a strong signal to the market through stringent policies that do not create unnecessary barriers to entry and competition, will allow new, cleaner technologies and business models to develop
- To help policymakers set the right balance, a set of new OECD environmental policy indicators has been developed: Environmental Policy Stringency (EPS) and the Burdens on the Economy due to Environmental Policies (BEEP)

What's the issue?

As environmental pressures continue to rise, governments throughout the OECD area have not been sitting back. If anything, the stringency of their policy measures has been increasing on the whole, not least to combat pollution and climate change.

But what about the effects of these actions on economic performance, on productivity for instance? New evidence from the OECD shows that more stringent environmental policies of recent years have had no negative effect on overall productivity growth. True, there may be winners and losers, but any effects have tended to fade away quickly.

In general, before tighter environmental policies came into effect, a country's overall productivity growth slowed, possibly because firms anticipated the changes and prepared themselves for new operating conditions. However, a rebound in productivity growth soon followed, with no cumulative loss reflected in the data.

The most productive, technologically advanced firms saw a temporary boost in productivity after rules became more stringent, as they moved to take advantage of new, more environmentally friendly opportunities, tap into their supply networks and reap the fruit of earlier innovations and their favourable market position. Less advanced firms saw their productivity fall, while some may have ceased activity altogether. However, policy efforts and the fact that resources can be reallocated into fast growing firms meant that the overall outcome was neutral, and aggregate productivity was unaffected.

See www.oecd.org/newsroom/photosandvideos/

"We need regulations that allow the penetration of clean technologies"

Simon Upton
OECD Environment Director

The policy message is clear: more stringent environmental policies, when properly designed, can be introduced to benefit the environment without any loss in productivity.

Why is this important?

Most OECD economies are still suffering from the aftermath of the economic crisis, and with unemployment at record highs, more effort is needed to achieve a marked and durable recovery. But efforts must also be stepped up to tackle climate change, pollution and other environmental challenges. A concern echoed by some governments is that stringent environmental policies will undermine productivity growth, and therefore should not be prioritised.

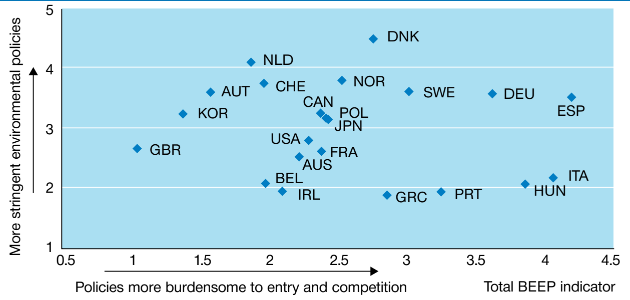
Our new evidence shows that environmental stringency policies do not have to hurt productivity. On the contrary, efforts to improve growth and achieve ambitious environmental goals can go together, and should be stepped up. Environmental policies can and should be shaped to spawn new ideas, mobilise cleaner technologies and encourage new business models that benefit both the economy and the environment.

What can policymakers do?

Governments should continue to tackle environmental problems with stringent environmental policies, but should devote resources to designing them properly. As a rule of thumb, to the extent possible, administrative procedures should be streamlined so as not to create barriers to doing business. Policies should avoid providing unwarranted advantages to existing firms, while more emphasis should be placed on flexible, market-based instruments, including taxes, as a key part of the policy mix.

Environmental stringency and market openness

Burdens on the economy from environmental policies (BEEP) and environmental policy stringency (EPS)



Stringent environmental policies do not have to act as economic burdens. Austria, Netherlands and Switzerland, for instance, combine stringent environmental policies with a relatively competition-friendly stance.

Note: Correlation between EPS and BEEP is not significant at 90% level.

Source: Kozluk (2014)

The aim is to orientate policies to foster new, cleaner technologies and allow competitive measures to remove old, dirty technologies and processes that hurt both growth and the environment.

To help strike the right balance, the OECD has developed the Environmental Policy Stringency Indicator (EPS), which summarises and compares the stringency of policy instruments among countries and over time. It currently focuses on climate and air pollution in energy and transport, and covers such policies as taxes, feed-in-tariffs, renewable energy certificates, R&D subsidies and emission limit values. Though a proxy, the indicator is the broadest and most comprehensive measure of its kind. Moreover, it is aligned with business perceptions of stringency.

To test the effectiveness of various environmental stringency indicators, policymakers can check them off against another innovation: the OECD BEEP, or Burdens on the Economy due to Environmental Policies. Though still under development, the BEEP shows that stringent environmental policies can be designed and implemented in different ways, and adjusted in relation to barriers to competition or administrative costs.

The BEEP indicator also reveals patterns among OECD countries (see chart). Austria, Netherlands and Switzerland, for instance, provide examples by combining stringent environmental policies with a relatively competition-friendly stance of such policies. The Nordic countries and Germany couple stringent environmental policies with high administrative burdens and measures that impede competition: in these cases a more competition-friendly stance could be achieved with similar environmental stringency. The UK could likely afford more stringent environmental policies without hurting competition, while Italy and Hungary could benefit from mixing tighter environmental policies with a more competition-friendly approach.

Policymakers should bear in mind three key principles when designing environmental policies:

- First, ensure strong signals come from stringent environmental policies, both to make pollution and climate change more costly, and clean and "green" approaches more attractive;
- Second, to the extent possible, use flexible policy instruments and leave it to the firms themselves to choose the most efficient way to innovate, adjust and "go green";
- Third, ensure environmental policy settings do not inhibit market entry or competition, give established firms advantages over new entrants in the market, or drive up administrative costs unnecessarily. This should lower the cost of market testing new, clean technologies and facilitate their adoption and diffusion.

In short, stringent environmental policies are not synonymous with higher burdens to entry and competition and, by devoting attention to designing policies in line with circumstances and best practices, policymakers can safely introduce stringent environmental policies without hurting productivity.

What's next?

To what extent can green and growth go hand in hand? Testing productivity gives only part of the answer, and the OECD intends to broaden the analysis of economic outcomes of environmental stringency policies to such areas as investment, employment, trade patterns and firm location – in particular to see if "pollution havens" are forming elsewhere, for instance, because of outsourcing, with no overall environmental gain to the planet. This means extending the indicators to cover more OECD and non-OECD countries, which would also help test the robustness of the results of the EPS proxy so far.

For more on how environmental policies matter for productivity growth, http://oe.cd/OQ

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