Green: What role government?

Address market failure.
Hint: It's not jobs

Running against conventional wisdom, some labor economists say it's unlikely that green jobs are going to be the revolution that some want or believe them to be.

Big deal, right? In the scheme of things, estimates are just estimates—no one gains or loses a future job, right? Things will sort themselves out later. In the meantime, pay no attention to those economists behind the curtain.

Except that there is a consequence if public policy is taking its cue from conventional wisdom—as appears to be the case—and policymakers prefer to focus on green job creation and co-opting the larger goal of limiting greenhouse gas (GHG) emissions and particulate pollution created by burning fossil fuels.

Some criticize all environmental regulation as bad. But markets do fail, and government has a unique role in correcting market failure. In this case, market forces have led to an overreliance on fossil-fuel-based production, failing to properly price the particulate pollution and GHG emissions that result. The best role for policy, therefore, is helping markets recognize, price and manage the pollution and emission problems of a carbon-intensive economy.

Some might assume that myriad existing laws, policies and programs at all levels of government are doing just that. But policy design is critical, and economic theory suggests that most of the green-chasing that goes for public policy today will not create the desired outcomes for either the economy or the environment.

From an economics point of view, the task for policymakers is to find the right tool for the right job. In this case, the "job" or underlying problem is not employment-based, but environment-based: Along with well-recognized pollution effects from fossil fuels, the current scientific consensus says that atmospheric levels of carbon dioxide, methane and other GHGs are too high, are a risk to the global climate and need to be reduced.

High unemployment is certainly a problem, but it's a separate problem—one that is not well aligned with the goal of reducing GHG emissions. Even if it were, the strategy of subsidizing green firms and jobs in hopes of creating net growth rests on weak evidence. Past research (including by the Minneapolis Fed) has shown that incentive wars among local and state governments to attract or retain jobs—green or not—is a zero-sum game at best. Though the competition often forces other governments to participate (or become the prey), that doesn't rationalize the competition itself.

If the problem at hand is excessive GHG emissions and other pollution, policy should focus on effective strategies for reducing them. Government's track record at inducing jobs in the private market is spotty, and attempting to create policy that both reduces GHG emissions and creates jobs risks doing a poor job of both.

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In terms of tools, economists prefer those that directly address a problem. In this case, the problem has to do with what economists call externalities—the harmful GHG emissions and pollution that are not included or captured in the price of fossil fuel. If society is getting too much of something it doesn't want, that means prices are too low; meanwhile, society bears these external costs in the form of environmental damage, health problems and the like.

So the right tool to reduce pollution and GHG emissions is to put a price on them, which will discourage their production as businesses and consumers avoid the higher cost of energy-intensive production techniques, running electronic gadgets all day long or driving five miles for a cup of coffee. Economists generally also prefer direct pricing—in this case, a tax on carbon emissions—over indirect pricing (like cap-and-trade permits) because the implementation of a tax is more straightforward and less prone to the political contortions that are invariably associated with cap-and-trade policies.

Other popular green policies—promoting energy efficiency or renewable energy use—are less efficient at reducing emissions because they suffer leakage. For example, greater energy efficiency is not always realized as lower carbon emissions; lower costs on your fuel bill might convince you to nudge up the thermostat a few degrees during the winter because of savings from energy efficiency.

Moving to economists' preferred policies to reduce GHG emissions and pollution is not presumed to be easy; indeed, setting the "right" price for these emissions is fraught with difficulty and comes loaded with transition costs as businesses and consumers adjust to new cost structures. The current tangle of green initiatives at all levels of government also is proof of society's dislike for recognizing these externality costs explicitly through taxation. It's often more palatable to promote well-intended policies that appear to avoid the trade-offs implied by higher taxes.

But good intentions—and the easier, more wide-ranging and incremental policies that have resulted—do not necessarily produce good outcomes and may ultimately be more harmful in ways not easily recognized. As currently designed, many environmental policies are doing double duty: attempting to reduce pollution and GHG emissions, and create jobs.

A full accounting suggests that such efforts tend not to yield many net jobs, nor do they achieve environmental goals that would be realized through a more direct policy approach. And all the while, significant financial and political capital is consumed avoiding hard policy choices and pursuing green jobs.

—Ronald A. Wirtz