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The green pseudo-revolution

Whatever the enviro-lobbyists say, subsidising inefficient green industries is not the way to tackle climate change



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With a worldwide recession advancing, strong action on global warming has been thrown into jeopardy. This matters, because in little more than a year, the world will sit down in Copenhagen to negotiate the follow-on treaty to the failed Kyoto Protocol. Yet, with people losing jobs and income, immediate economic help seems to matter more than temperature differentials 100 years from now.

Many green pundits have, however, started saying that the financial crisis only makes the need for action on climate change greater. They urge America's president-elect Barack Obama to pursue a "green revolution" with big investments in renewable energy, arguing that this could create millions of new "green collar" jobs and open huge new markets. Such sentiments, no surprise, are strongly voiced by business leaders who live off such subsidies. But are such pleas smart investments for society?

The problem with the green revolution argument is that it doesn't trouble itself about efficiency. It is most often lauded for supplying new jobs. But billions of dollars in tax subsidies would create plenty of new jobs in almost any sector: the point is that many less capital-intensive sectors would create many more jobs for a given investment of taxpayers' money.

Similarly, green initiatives will open new markets only if other nations subsidise inefficient technologies bought abroad. Thus, the real game becomes which nations get to suck up other nations' tax-financed subsidies. Apart from the resulting global inefficiency, this also creates a whole new raft of industry players that will keep pushing inefficient legislation, simply because it fills their coffers.

A good illustration is Denmark, which early on provided huge subsidies for wind power, building thousands of inefficient turbines around the country from the 1980s onwards. Today, it is often remarked that Denmark is providing every third terrestrial wind turbine in the world, creating billions in income and jobs.

A few years ago, however, the Danish Economic Council conducted a full evaluation of the wind turbine industry, taking into account not only its beneficial effects on jobs and production, but also the subsidies that it receives. The net effect for Denmark was found to be a small cost, not benefit.

Not surprisingly, the leading Danish wind producer is today urging strong action on climate change that would imply even more sales of wind turbines. The company sponsors the "Planet in Peril" show on CNN, which helps galvanize public pressure for action.

The crucial point is that many green technologies are not cost-effective, at least not yet. If they were, we wouldn't need to subsidise them.

The standard reply is that green technologies seem more expensive only because the price of fossil fuels does not reflect their climate costs. That makes some sense. Given that fossil fuels contribute to global warming, standard economic theory suggests we should tax them according to their cumulative negative effects.

But this would make little difference to the inefficiency of most green technologies. The most comprehensive economic meta-study shows that total future climate impacts justify a tax of €0.012 per litre of petrol (\$0.06 per gallon in the US). This is dwarfed by the tax that many European countries already impose, and it is much less than in the European trading system.

Yet it is argued that much higher taxes and subsidies are the best way to increase research and development in new, cheaper renewable energy sources. This is untrue. During the massive investment associated with the Kyoto treaty, the participating countries' investment in R&D as a percentage of GDP has declined, not increased. It is rather obvious that if you invest massively in inefficient solar panels, most of your money will go to buy the physical panels, whereas only a very small part will go to R&D. If you want more R&D, you should spend your money directly on R&D. This could tackle global warming in the longer run.

Finally, it is often claimed that high CO₂ taxes and subsidies for green technology will actually do good, and again Denmark is often taken as an example. After all, it is argued, Denmark has kept its CO₂ emissions flat while enjoying 70% economic growth since 1981. But could it have grown more if it had not restricted CO₂ emissions? During the same period, US emissions grew 29%, but its GDP grew 39% more than Denmark's, indicating a simple truth: CO₂ cuts and subsidies don't necessarily mean no growth, but they probably do mean slower growth.

President-elect Obama is now facing countless people who claim that subsidies for renewable energy and CO₂ taxes are great ways to tackle global warming and forge a new green economy. Unfortunately, this is almost entirely incorrect. Taxes and subsidies are always expensive, and will likely impede growth. Moreover, if we really want to tackle global warming, we shouldn't spend vast sums of money buying inefficient green technology – we should invest directly in R&D to make future green technology competitive.

Obama should seize the initiative and make the meeting in Copenhagen next year not about bloated subsidies for inefficient technologies, but about lean investments in future breakthroughs. That is the way to tackle global warming and support a genuinely vibrant economy.

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