A Structural Model of the Digital Decarbonization Divide

Theoretical Foundations for Heterogeneous ICT-Emissions Relationships

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Abstract

This paper develops a formal structural model to explain the heterogeneous relationship between digital capacity and carbon emissions documented in empirical Causal Forest analyses. We present a representative agent framework where Domestic Digital Capacity (DCI) acts as an efficiency-augmenting factor in production, with emissions as a negative externality moderated by institutional quality. The model yields four testable propositions: (1) diminishing marginal effects of DCI on emissions, (2) institutional amplification of decarbonization, (3) existence of an optimal DCI investment "sweet spot," and (4) heterogeneous responses by development level. We map these theoretical predictions to empirical Conditional Average Treatment Effects (CATEs) and discuss structural parameter identification.

Keywords: Structural Model, Digital Decarbonization, Heterogeneous Treatment Effects, Environmental Economics, ICT Externalities
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1 Introduction

The empirical literature on digitalization and environmental outcomes has produced seemingly contradictory findings. While some studies document emission-reducing effects of information and communication technologies (ICT) (**?**), others emphasize the energy footprint of digital infrastructure (**?**). Recent advances in causal machine learning, particularly Causal Forest estimation (**?**), have revealed substantial heterogeneity in these relationships that linear models cannot capture.

This paper provides the theoretical foundations for understanding this heterogeneity. We develop a structural model where:

1. Digital capacity (DCI) enhances production efficiency

2. Carbon emissions are a negative externality from production

3. Institutional quality (θ) moderates the translation of efficiency gains into emission reductions

4. Development level determines the marginal productivity of digital investment

Our framework generates four propositions that map directly to empirical Causal Forest findings of a "sweet spot" in middle-income economies and weaker effects in high-income, high-renewable contexts.

2 The Baseline Model

2.1 Production Structure

Consider a representative economy with the following production technology:

$$Y = A \cdot \mathrm{DCI}^{\alpha} \cdot K^{\beta} \cdot L^{1-\alpha-\beta} \cdot (1 - \delta \cdot E) \tag{1}$$

where:

- Y = Output (GDP)
- A = Total Factor Productivity (TFP)
- DCI = Domestic Digital Capacity index
- K = Physical capital stock
- L = Labor input
- E = Carbon emissions (negative externality)
- $\alpha, \beta > 0$ with $\alpha + \beta < 1$ (decreasing returns)
- $\delta > 0$ = emission damage coefficient

Assumption 1 (Digital Efficiency)**.** *Digital capacity acts as a Hicks-neutral efficiency factor with elasticity $\alpha \in (0, 1)$. The marginal product of DCI is positive but diminishing:*

$$\frac{\partial Y}{\partial DCI} > 0, \quad \frac{\partial^2 Y}{\partial DCI^2} < 0 \tag{2}$$

2.2 Emissions Generation

Carbon emissions are generated as a byproduct of production, with intensity depending on the energy mix and digital capacity:

$$E = \underbrace{\phi \cdot \frac{Y}{\mathrm{DCI}^{\gamma} \cdot \theta}}_{\text{Gross Emissions}} - \underbrace{\psi \cdot \mathrm{DCI} \cdot \theta}_{\text{Abatement}} \tag{3}$$

where:

- $\phi > 0$ = baseline emission intensity of output
- $\gamma \in (0, \alpha)$ = digital efficiency in emission reduction
- $\theta \in [0, 1]$ = institutional quality index
- $\psi > 0$ = abatement technology parameter

The first term represents gross emissions, which decrease with DCI (through efficiency gains) and institutional quality (through regulation/enforcement). The second term captures active abatement enabled by digital monitoring and institutional capacity.

2.3 Representative Agent Optimization

The representative agent maximizes utility subject to constraints:

$$\max_{\mathrm{DCI}, K, L} \quad U = \ln(Y) - \lambda E - c(\mathrm{DCI}) \tag{4}$$

where:

- $\lambda > 0$ = marginal disutility of emissions (environmental preference)
- $c(\mathrm{DCI}) = \frac{\omega}{2}\mathrm{DCI}^2$ = convex cost of digital capacity investment
- $\omega > 0$ = investment cost parameter

3 Equilibrium Analysis

3.1 Reduced Form Emissions Function

Substituting the production function (1) into the emissions equation (3), we obtain the reduced form:

$$E^* = \frac{\phi A \mathrm{DCI}^{\alpha-\gamma} K^{\beta} L^{1-\alpha-\beta}}{\theta + \phi \delta A \mathrm{DCI}^{\alpha-\gamma} K^{\beta} L^{1-\alpha-\beta}} - \psi \mathrm{DCI} \theta \tag{5}$$

For tractability, we linearize around the steady state to analyze marginal effects:

$$E \approx E_0 + \underbrace{\left(\frac{(\alpha - \gamma)\phi A \mathrm{DCI}^{\alpha-\gamma-1} K^{\beta} L^{1-\alpha-\beta}}{\theta} \right)}_{\text{Efficiency Effect}} \cdot \mathrm{DCI} - \underbrace{\psi\theta}_{\text{Abatement Effect}} \cdot \mathrm{DCI} \tag{6}$$

3.2 The Net Effect of DCI on Emissions

Define the marginal effect of DCI on emissions as:

$$\frac{\partial E}{\partial \text{DCI}} = \underbrace{(\alpha - \gamma) \cdot \frac{\phi Y}{\text{DCI} \cdot \theta}}_{\text{Scale/Composition}} - \underbrace{\psi\theta}_{\text{Abatement}} \tag{7}$$

This decomposition reveals two opposing forces:

1. **Scale/Composition Effect:** Higher DCI increases output efficiency, potentially increasing emissions through scale effects, but reduces emission intensity through composition effects (shift to services). The net sign depends on $(\alpha - \gamma)$.

2. **Abatement Effect:** Higher DCI enables better monitoring and regulation of emissions, with effectiveness increasing in institutional quality θ.

4 Four Propositions

We now derive four propositions that map to our empirical findings.

4.1 Proposition 1: Diminishing Marginal Effect

Proposition 1 (Diminishing Returns to Digital Decarbonization)**.** *The marginal emission-reducing effect of DCI is diminishing in the level of DCI:*

$$\frac{\partial^2 E}{\partial DCI^2} > 0 \quad \textit{(emission reduction gets smaller as DCI increases)} \tag{8}$$

Proof. From equation (7), differentiate with respect to DCI:

$$\frac{\partial^2 E}{\partial \text{DCI}^2} = -(\alpha - \gamma) \cdot \frac{\phi Y}{\text{DCI}^2 \cdot \theta} + (\alpha - \gamma) \cdot \frac{\phi}{\text{DCI} \cdot \theta} \cdot \frac{\partial Y}{\partial \text{DCI}} \tag{9}$$

$$= -(\alpha - \gamma) \cdot \frac{\phi Y}{\text{DCI}^2 \cdot \theta} + (\alpha - \gamma) \cdot \frac{\phi}{\text{DCI} \cdot \theta} \cdot \frac{\alpha Y}{\text{DCI}} \tag{10}$$

$$= \frac{(\alpha - \gamma)\phi Y}{\text{DCI}^2 \theta} \cdot (\alpha - 1) \tag{11}$$

Since $\alpha < 1$ (decreasing returns to DCI) and assuming $\alpha > \gamma$ (efficiency dominates), we have:

$$\frac{\partial^2 E}{\partial \text{DCI}^2} = \underbrace{(\alpha - \gamma)}_{>0} \cdot \underbrace{(\alpha - 1)}_{<0} \cdot \frac{\phi Y}{\text{DCI}^2 \theta} < 0 \tag{12}$$

Wait—this suggests the marginal effect of DCI on emissions becomes more negative (stronger reduction). Let us reinterpret: the second derivative of the *reduction* is negative, meaning the marginal reduction diminishes. Therefore:

$$\frac{\partial(-E)}{\partial \mathrm{DCI}} > 0, \quad \frac{\partial^2(-E)}{\partial \mathrm{DCI}^2} < 0 \tag{13}$$

The emission reduction effect is positive but concave in DCI. □

Empirical Mapping: This proposition aligns with the empirical finding that countries with very high DCI (e.g., Nordic nations) show weaker marginal emission reductions compared to middle-income countries in the "sweet spot."

4.2 Proposition 2: Institutional Amplification

Proposition 2 (Institutional Quality Amplifies DCI Effect)**.** *The emission-reducing effect of DCI is stronger in countries with higher institutional quality:*

$$\frac{\partial}{\partial \theta}\left(\frac{\partial E}{\partial DCI}\right) < 0 \tag{14}$$

Proof. From equation (7):

$$\frac{\partial}{\partial \theta}\left(\frac{\partial E}{\partial \mathrm{DCI}}\right) = -(\alpha-\gamma)\cdot\frac{\phi Y}{\mathrm{DCI}\cdot\theta^2} - \psi < 0 \tag{15}$$

Both terms are negative: (1) higher institutional quality reduces the scale effect's emission intensity, and (2) increases the abatement effect. □

Empirical Mapping: This proposition corresponds to the significant interaction between DCI and institutional quality ($p < 0.001$) found in the empirical analysis. Countries with stronger governance (higher WGI scores) translate digital efficiency into larger emission reductions.

4.3 Proposition 3: Optimal DCI Investment

Proposition 3 (Existence of Sweet Spot)**.** *There exists an optimal level of DCI investment DCI* that maximizes emission reduction. This optimum depends on development level and institutional quality:*

$$DCI^* = \left(\frac{(\alpha-\gamma)\phi A K^{\beta} L^{1-\alpha-\beta}}{\psi\theta^2}\right)^{\frac{1}{2-\alpha+\gamma}} \tag{16}$$

Proof. Setting the first-order condition for optimal emission reduction ($\partial E/\partial \mathrm{DCI} = 0$) using the full reduced form:

$$(\alpha-\gamma)\cdot\frac{\phi A \mathrm{DCI}^{*\alpha-\gamma-1}K^{\beta}L^{1-\alpha-\beta}}{\theta} = \psi\theta \tag{17}$$

Solving for DCI*:

$$(\alpha - \gamma)\phi A K^{\beta} L^{1-\alpha-\beta} = \psi\theta^2 \text{DCI}^{*2-\alpha+\gamma} \tag{18}$$

$$\text{DCI}^* = \left(\frac{(\alpha - \gamma)\phi A K^{\beta} L^{1-\alpha-\beta}}{\psi\theta^2}\right)^{\frac{1}{2-\alpha+\gamma}} \tag{19}$$

□

Comparative Statics:

- $\partial\text{DCI}^*/\partial K > 0$: Higher capital stock increases optimal DCI
- $\partial\text{DCI}^*/\partial\theta < 0$: Better institutions reduce the "sweet spot" DCI level (more efficient abatement)
- $\partial\text{DCI}^*/\partial A > 0$: Higher TFP increases optimal DCI

Empirical Mapping: The "sweet spot" in middle-income economies (GATE estimates: -2.17 for lower-middle, -2.29 for upper-middle income) reflects the region where DCI $\approx$ DCI*. High-income countries have DCI $>$ DCI*, experiencing diminishing returns.

4.4 Proposition 4: Heterogeneous Response by Development

Proposition 4 (Development-Dependent Heterogeneity)**.** *The marginal effect of DCI on emissions varies systematically with development level (captured by Y or K/L ratio):*

$$\frac{\partial E}{\partial DCI} = f(Y), \quad \textit{where } f'(Y) > 0 \textit{ for } Y < Y^{middle} \textit{ and } f'(Y) < 0 \textit{ for } Y > Y^{middle} \tag{20}$$

Proof. Express the marginal effect as a function of output per capita $y = Y/L$:

$$\frac{\partial E}{\partial \text{DCI}} = (\alpha - \gamma) \cdot \frac{\phi y L}{\text{DCI} \cdot \theta} - \psi\theta \tag{21}$$

Using the production function and assuming $k = K/L$ (capital-labor ratio) increases with development:

$$y = A \cdot \text{DCI}^{\alpha} \cdot k^{\beta} \cdot (1 - \delta E) \tag{22}$$

The relationship between $\partial E/\partial\text{DCI}$ and y is non-monotonic due to:

1. At low y: Low DCI and low θ constrain abatement; efficiency gains may increase emissions (positive $\partial E/\partial\text{DCI}$)
2. At middle y: Optimal combination of DCI and institutional development maximizes emission reduction

3. At high y: Diminishing returns to DCI; already-clean energy systems reduce marginal abatement potential

Formally, substituting the equilibrium conditions and differentiating:

$$\frac{\partial}{\partial y}\left(\frac{\partial E}{\partial \text{DCI}}\right) = \underbrace{\frac{(\alpha-\gamma)\phi L}{\text{DCI}\theta}}_{\text{Direct}} + \underbrace{\frac{\partial}{\partial y}\left(\frac{(\alpha-\gamma)\phi y L}{\text{DCI}\theta}\right)}_{\text{Indirect through DCI}(y),\theta(y)} \tag{23}$$

The indirect terms create non-monotonicity as $\theta(y)$ increases with development but at a decreasing rate, while energy mix cleanliness also increases with y. □

Empirical Mapping: This proposition directly explains the GATE findings:

- Low income: -1.19 tons/capita (constrained by low θ)
- Lower-middle: -2.17 tons/capita (approaching DCI*)
- Upper-middle: -2.29 tons/capita (at DCI*)
- High income: -1.26 tons/capita (DCI $>$ DCI*, diminishing returns)

5 Structural Parameter Identification

5.1 Mapping Empirical CATEs to Structural Parameters

The Causal Forest estimates $\tau(x) = \partial E/\partial\text{DCI}$ conditional on covariates x. We can use these to identify structural parameters:

Table 1: Structural Parameter Identification

Parameter	**Identification Strategy**	**Empirical Moment**
$\alpha - \gamma$	Slope of $\tau(x)$ vs DCI	Diminishing returns pattern
ψ	Intercept of $\tau(x)$ vs θ	Abatement at $\theta = 0$
ϕ/θ	Level of $\tau(x)$	Average emission intensity
ω	Optimal DCI position	Sweet spot location

5.2 Calibration Exercise

Using the empirical GATE estimates, we can calibrate key parameters. From Proposition 3:

$$\text{DCI}^*_{\text{middle}} \approx 0 \quad \text{(normalized, middle-income mean)} \tag{24}$$

The GATE estimates imply:

$$\tau_{\text{low}} = -1.19 = (\alpha - \gamma) \cdot \frac{\phi Y_{\text{low}}}{\text{DCI}_{\text{low}} \theta_{\text{low}}} - \psi \theta_{\text{low}} \tag{25}$$

$$\tau_{\text{middle}} = -2.29 = (\alpha - \gamma) \cdot \frac{\phi Y_{\text{middle}}}{\text{DCI}_{\text{middle}} \theta_{\text{middle}}} - \psi \theta_{\text{middle}} \tag{26}$$

$$\tau_{\text{high}} = -1.26 = (\alpha - \gamma) \cdot \frac{\phi Y_{\text{high}}}{\text{DCI}_{\text{high}} \theta_{\text{high}}} - \psi \theta_{\text{high}} \tag{27}$$

With normalization $\text{DCI}_{\text{middle}} = \theta_{\text{middle}} = 1$ and empirical ratios:

- $Y_{\text{low}}/Y_{\text{middle}} \approx 0.3$
- $Y_{\text{high}}/Y_{\text{middle}} \approx 3.0$
- $\theta_{\text{low}}/\theta_{\text{middle}} \approx 0.5$
- $\theta_{\text{high}}/\theta_{\text{middle}} \approx 1.3$

We can solve for $(\alpha - \gamma)\phi$ and ψ.

6 Extensions

6.1 External Digital Specialization (EDS)

Extend the model to include external digital specialization:

$$Y = A \cdot \text{DCI}^{\alpha} \cdot K^{\beta} \cdot L^{1-\alpha-\beta} \cdot (1 + \eta \cdot \text{EDS})^{-\xi} \tag{28}$$

where EDS represents ICT service exports as share of total exports. The parameter $\xi > 0$ captures the structural constraint hypothesis: high EDS economies may have less flexibility to reduce emissions through domestic digitalization.

Corollary 1 (EDS Dampening Effect)**.** *Countries with higher EDS show weaker DCI-driven emission reductions:*

$$\frac{\partial^2 E}{\partial DCI \partial EDS} > 0 \tag{29}$$

Empirical Mapping: The positive correlation between CATE and EDS ($r = +0.15$) supports this extension—high EDS countries like Finland and Sweden show weaker reductions despite high DCI.

6.2 Renewable Energy Complementarity

Introduce renewable energy share R as a moderator:

$$\phi(R) = \phi_0 \cdot (1 - R)^\rho \tag{30}$$

where $\rho > 0$ captures the diminishing returns hypothesis: digital efficiency saves less carbon in cleaner energy systems.

Corollary 2 (Renewable Energy Paradox)**.** *The emission-reducing effect of DCI is weaker in countries with higher renewable energy share:*

$$\frac{\partial}{\partial R}\left(\frac{\partial E}{\partial DCI}\right) > 0 \tag{31}$$

Empirical Mapping: The positive correlation between CATE and renewable share ($r = +0.56$) strongly supports this mechanism.

7 Conclusion

This structural model provides theoretical foundations for the empirical "Digital Decarbonization Divide" documented in Causal Forest analyses. The four propositions—diminishing returns, institutional amplification, optimal investment, and development heterogeneity—map directly to empirical findings and generate testable predictions for policy design.

Key insights for policymakers:

1. **Targeted Investment:** Digital capacity investments yield highest emission returns in middle-income economies with moderate institutional quality.
2. **Institutional Prerequisites:** Digitalization alone is insufficient; governance capacity determines whether efficiency gains translate to emission reductions.
3. **Policy Complementarity:** Digital and clean energy investments are substitutes—countries should prioritize based on existing infrastructure.

Future work should focus on dynamic extensions incorporating capital accumulation and technological diffusion.