

When the Best is the Enemy of the Good: Minimizing the Impact of Political Constraints on Climate Policy Costs

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EXECUTIVE SUMMARY

MOST COUNTRIES HAVE AMBITIOUS GOALS FOR REDUCING THEIR GREENHOUSE GAS EMISSIONS BUT FACE CHALLENGES IN TRANSLATING THESE TARGETS INTO CONSISTENT POLICIES AND ACTIONS. THESE HEADWINDS HAVE SLOWED THE ENACTMENT OF CLIMATE POLICIES, AND HAMPERED COUNTRIES' PROGRESS TOWARDS ACHIEVING THEIR EMISSIONS TARGETS. IN "THE TIMING VERSUS ALLOCATION TRADE-OFF IN POLITICALLY CONSTRAINED CLIMATE POLICIES", ADAM MICHAEL BAUER, STÉPHANE HALLEGATTE, AND FLORENT MCISSAAC DEVELOP A MODELING FRAMEWORK TO UNDERSTAND HOW POLITICAL CONSTRAINTS CHANGE THE LEAST-COST APPROACH TO ACHIEVING CLIMATE OBJECTIVES.

This Policy Brief is based on the webinar of the 27th of January 2025 with Adam Bauer and hosted by Michael Barnett (Arizona State University – W. P. Carey School of Business) entitled "The Timing versus Allocation Trade-off in Politically Constrained Climate Policies".

Policy Brief

Context: Climate Policies Under Political Constraints

Challenges to meeting national and international climate goals – such as thin legislative majorities, bureaucratic red tape, concerns over industrial competitiveness and concentrated job losses, and powerful lobby groups with de facto veto power – inhibit governing bodies from implementing the least-cost policies to achieve their climate targets. In response to these challenges, policymakers often utilize second-best policy instruments (such as sector-specific subsidies or regulations) in order to assuage political constraints while still making progress towards their climate goals.

In choosing the second-best policy suite, decision-makers face a critical choice: is it better to (1) take more time to design a decarbonization strategy that allocates efforts optimally across the economy, or (2) to act in each sector as soon as possible, even at the expense of allocational efficiency? This question is especially important when economy-wide climate policies are threatened by strong opposition in one or a few politically sensitive sectors; excluding these sectors from, say, a carbon tax program, could require increased efforts in covered sectors that would raise aggregate policy costs. Addressing this question is the central theme of the paper, where the authors discuss how political constraints impact the costliness of achieving climate goals.

Ranking the Costliness of Second-Best Climate Policies

The paper presents a hierarchy of second-best policies that delay the green transition and develops a modeling framework to quantify their impact on policy costs. Note each percentage below is relative to the least-cost policy.

- **Relaxation of Policy Stringency.** In this suite, the policymaker enacts a carbon price immediately, but deflates this carbon price in a set of sectors in which action is more politically challenging. This could represent a case where there is an economy-wide carbon price, but special exemptions lower the effective carbon price in politically sensitive sectors. Numerical simulations suggest that this policy suite increases total policy costs by 2% at the maximum.
- **Delaying Politically Sensitive Sectors.** Here a set of politically challenged sectors are completely exempt from the carbon tax, while the remaining sectors face the tax. This approach could emulate that of a governing body that is concerned about the competitiveness of its domestic industries, and so exempts the entire industrial sector from their emissions tax. This policy approach increases policy costs by about 12% at most.
- **Economy-wide Delay.** Finally, the policymaker delays the implementation of climate policies across the entire economy until they can overcome political constraints, after which they can implement the optimal policy. The additional costs of this policy approach can amount to over 50%.

Key Findings

Why is delaying climate policies economy-wide so much more expensive than relaxing them? The reason is that the required pace of emissions reductions is much higher when policies are delayed relative to when they are relaxed. This is because of “adjustment costs” that make reducing emissions over a shorter time horizon more expensive (compared with a slower implementation of the same changes). As an example, retrofitting many buildings in a few years is significantly more expensive than doing it over decades. This is because the heightened pace of retrofitting requires mobilizing and training a larger group of workers, while also risking scarcity in materials and labor in other sectors of the economy. These “adjustment costs” are limited when policies are relaxed, however, as one can smooth out their effects over time.

The same logic supports the second key conclusion of the paper, which is that sectors with high annual emissions rates (not the highest costs) are the most expensive sectors to delay. This is because delaying the decarbonization of high emitting sectors forces more emissions reduction efforts in other sectors (compared to delaying action in a sector with low emissions). The other sectors are therefore decarbonized quickly, incurring adjustment costs that increase the overall cost of policy.

Implications for Policy

The findings of the paper underscore the key trade-offs in formulating climate policies under political constraints. These trade-offs can be summarized as:

- **The perfect, coordinated policy cannot be the enemy of the good, less coordinated policy.** The political realities of climate change require compromise, and policymakers should focus on implementing feasible climate policies, even if they are sectorally uncoordinated, as opposed to waiting to implement the most efficient policy later.
- **High emissions sectors are the most costly to delay.** High emitting sectors, such as energy, are expensive to delay because their delay significantly increases the rate of emissions reductions in other sectors. This leads to a faster transition in other sectors, incurring more adjustment costs and therefore higher policy costs.



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