

# Discussion of

# IFI: Assessing the Fiscal Impact of Climate Transition

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# THE IFI PAPER...

- ... provides a systematic **overview on channels** from climate policy/climate change to public finances emphasizing **second-round effects**,
- ... discusses **risks/uncertainty of climate-related fiscal forecasts** for both short- and long-term,
- ... reports on the **current (infant) stage of climate-related fiscal forecasting** (models, resources, practice),
- ... presents (current) **best practices** from the two front runners: Dutch CPB and UK's OBR, and
- ... concludes with some **pragmatic recommendations** (e.g., multi-scenario, continuous forecasts, focus on cost estimates of mitigation).

# MY COMMENTS

**Long-run uncertainty** of climate-related fiscal forecasts (CRFF) is qualitatively different as compared to other long-run trends (demographics).

We must be aware how the **political economy of CRFF** interacts with this uncertainty („wishful thinking“).

There are **good arguments to focus CRFF on the short- and medium-term**.

CRFF and **free-riding** of national climate policies.

CRFF should consider to **inform on implicit price of carbon of national climate strategies** as well.

# COMPARING TWO LONG-RUN TRENDS

	Climate change	Demographic change
Time horizon:	Very long: coming generations	Long: next two generations
Trend is driven by ...	... anthropogenic climate change (GHG emissions – climate – temperature – ecological/economic consequences)	... low fertility combined with increasing longevity, medical progress, migration
Uncertainty relates to ...	...biophysical mechanisms, large confidence intervals	... demographic parameters, smaller confidence intervals
Long-run uncertainty on economic and fiscal consequences ...	... very large (wrt e.g. to growth effects, fiscal costs)	... more limited: We know the crucial parameters of the pension system
Do consequences depend on global policies as well:	yes, climate is a global public good	no, only weak global links (migration, global capital market)
<b>Overall uncertainty long-run fiscal forecasts</b>	<b>Very high (close to “speculation”)</b>	<b>More limited</b>

# POLITICAL ECONOMY OF FISCAL FORECASTS

- Governments are over-optimistic on growth and on revenues.
- Partisan or election cycle motives matter as well.

Bischoff, I., and Gohout, W. (2010). The Political Economy of Tax Projections. *International Tax and Public Finance*. 17(2): 133-150.

Buettner, T., and Kauder, B. (2015). Political Biases Despite External Expert Participation? An Empirical Analysis of Tax Revenue Forecasts in Germany. *Public Choice*. 164(3-4): 287-307.

Jonung, L., Larch, M. (2006). Improving Fiscal Policy in the EU: The Case for Independent Forecasts. *Economic Policy*. 21(47): 491-529.

Lehmann, R., and Wollmershäuser, T. (2020). The Macroeconomic Projections of the German Government: A Comparison to an Independent Forecasting Institution. *German Economic Review*. 21(2): 235-270.

- This paper: “some IFIs deem the current assessments biased”; lack of interest in long-term forecasts; models that assume climate policy investment to increase growth
- Large uncertainty of CRFF offers a particularly large leeway for „wishful thinking“

**The large uncertainty is a particularly compelling argument for IFIs to get involved**

# ARGUMENTS WHY IFIs SHOULD FOCUS CRFF ON SHORT- AND MEDIUM-RUN

- **Uncertainty on long-run fiscal costs** is so substantial that forecasts are close to speculation.
- Risk that IFIs lose **reputation** when they embark on this speculation.
- Huge confidence intervals leave **long-run forecasts hardly helpful** for to guide climate policy today.
- Crucial function of CRFF should be to **guide public and governments on its current climate strategy** and to assess the fiscal perspective over that (short and medium) phase.

# CRFF APPROACH MUST AVOID TO REWARD FREE RIDERS

- A free-riding country could largely concentrate on adaptation and „save“ mitigation costs.
- This would lead to a mild short- and medium-term fiscal burden for the individual country.

**CRFFs can be misleading if they inform on fiscal costs without relating it to the country's contribution to the global public good.**



# CRFF COULD CONSIDER TO ASSESS THE IMPLICIT PRICE OF CARBON IN GOVERNMENT STRATEGIES

The paper rightly observes:

- Political economy pressures: choice of politically attractive but inefficient climate policy choices.
- Important that climate transition measures are timely, well-targeted and cost-efficient.

**But one conclusion is missing:**

- Relate fiscal costs to emission reduction – **quantify a country's climate policy strategy's implicit price of carbon.**
- Fiscal forecasts would then also be informative **on a country's climate policy efficiency.**
- Looking at fiscal costs in relation to emission reduction also indispensable to **identify free-riding countries.**