Strengthening the recovery and accelerating the green transition in Hungary

Category: Green growth,Hungary,Uncategorized
written by oecdecoscope | March 6, 2024

By Pierre-Alain Pionnier and Donal Smith

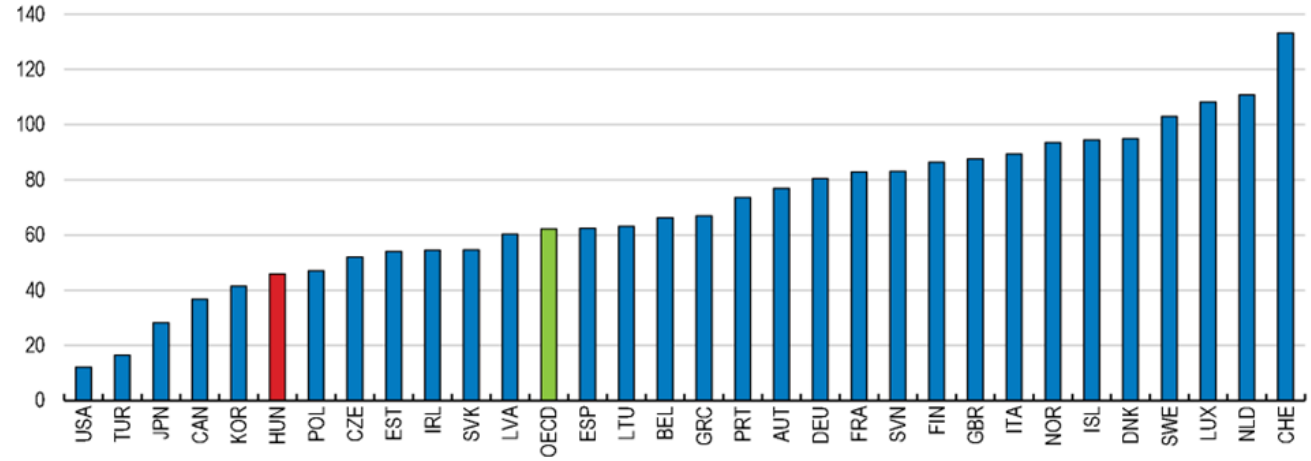
After a strong demand-based recovery from the economic fallout of the COVID-19 pandemic, Hungary's economy contracted in 2023 while inflation climbed higher than elsewhere in the European Union, at some point surpassing 25%. The good news is that growth has restarted in mid-2023 and inflation is receding. At the same time, both fiscal and monetary policies will need to work hand-in-hand to fight remaining inflationary pressures and recreate fiscal space for future spending needs, as highlighted by the recently published OECD Economic Survey of Hungary (OECD, 2024).

One of the big challenges of the next decades will be to move towards a greener and more sustainable economy. Hungary has made progress in this direction, but this progress needs to accelerate. For a large part, emission reductions achieved so far have been related to the changing industry structures as the economy transitioned to a market economy in the early 1990s. Regulations and standards are currently the main tools used to support the green transition, but they will likely be insufficient to reach the 2030 and 2050 emission targets. Price signals are key for an efficient decarbonisation. The

European Union’s Emission Trading Scheme is the main price-based measure to curb emissions in Hungary, but it only covers a third of emissions. As a result, average carbon prices are low in international comparison, exacerbated by energy subsidies on fossil fuels (Figure 1).

Figure 1. Carbon prices are low

Net effective carbon rates, all sectors, EUR per tonne of CO_2, 2021

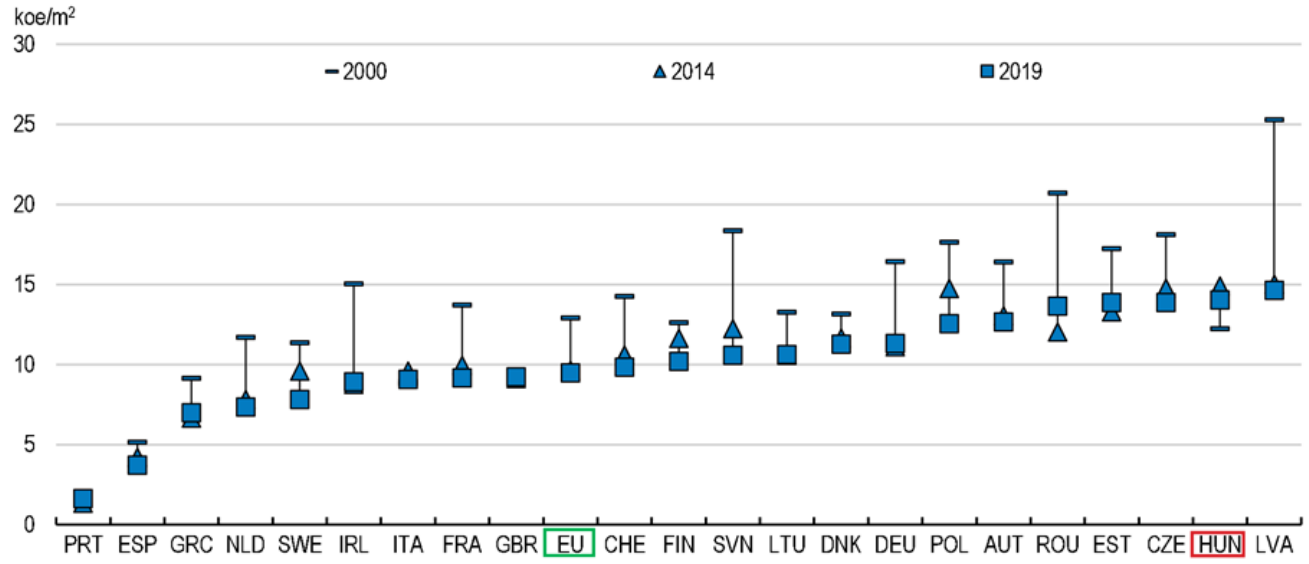


Note: Net effective carbon rates consist of emission trading prices, carbon taxes, and fuel excise taxes, minus fossil fuel subsidies. The OECD average is an unweighted average of net effective carbon rates across OECD countries.
Source: (OECD, 2022)

In the residential sector, price caps keep retail electricity and gas prices low for many households. Along with poor dwelling insulation, this may explain why household energy consumption is among the highest in Europe (Figure 2). If energy support to households were restructured and price caps replaced with targeted cash transfers, this would not only protect vulnerable households, but it would also improve energy efficiency incentives and cost less, as energy subsidies reached 2.5% of GDP in 2023. Part of the fiscal savings could be allocated to upgrade the housing stock of financially constrained households.

Figure 2. Households' energy consumption is high

Energy consumption of households for heating, in kilograms of oil equivalent (koe) per m²



Note: For each country, energy consumption is corrected for changes in meteorological conditions across years.
Source: Odysee-Mure, https://www.odyssee-mure.eu/

Emissions from the transport sector have increased since 1990 and now represent 20% of overall greenhouse gas emissions. Car ownership has expanded along with rising income levels, but Hungarians drive one of the oldest car fleets in Europe, and over longer distances than elsewhere in Europe. Transport emissions could be limited through better incentives to replace high-polluting cars and choose public transportation where available, but also by improving the quality of public transportation and limiting urban sprawl, especially around Budapest.

On the supply side, meeting emission targets will require a significant increase in electricity production from low-carbon sources. Current plans are mostly focused on solar energy and biomass, particularly wood. While burning wood is a low-emission energy source seen over the long run, when accounting for the replanting of trees, in the short run it would increase emissions and reinforce an already acute air

pollution problem. Hungary could make better use of its potential for wind and geothermal energy, but that will require removing restrictive rules on windmill installation and easing licensing procedures for geothermal energy projects. Moreover, the development of intermittent energy sources like solar and wind energy will require massive investments in the electricity grid.

Ensuring a sufficient low-carbon electricity supply will be a challenge. Hungary currently imports 40% of its electricity from neighbouring countries, which are engaged in a similar decarbonisation process. Eventually, Hungary will also have to replace an ageing nuclear plant, and large projects like this can be subject to financial, technical, and even geopolitical risks.

All of these considerations will make it even more important to speed up progress on rolling out low-carbon renewable energy sources. Only this can make Hungary’s progress towards living standards more sustainable and leave a brighter future for the next generation.

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Making the grass greener: the role of firms' financial and managerial capacity in paving the way to the green transition

Category: Climate,Green growth,Uncategorized
written by oecdecoscope | March 6, 2024

By Hélia Costa, Lilas Demmou, Guido Franco, Stefan Lamp

The ambitious targets set by many OECD countries to become carbon neutral by 2050 require substantial investment. The European Commission estimates that relevant investment will need to be raised from an average of €683 billion per year to around €1,040 billion per year until 2030 (Lenaerts et al., 2021). According to the International Energy Agency, global energy investment will need to almost double to 4.5% of global GDP by 2030 and remain at this level until 2050. Furthermore, this investment will have to be shouldered mainly by the private sector, responding to market signals and policies set by governments (IEA, 2021).

Green investment efforts to date however fall well short of the zero-emission scenario (ECB, 2023). Various factors may contribute to this. Particularly, financing investment in such technologies may be more difficult to obtain compared to other, more established, technologies, due to specific

characteristics like high fixed costs and risk, or information asymmetries (De Haas and Popov, 2023). Investments in newer and riskier green technologies may also be deferred due to a lack of knowledge among firms regarding this specific type of investment and how to manage it effectively (De Haas et al., 2022).

Against this backdrop, our new paper (Costa et al., 2024) delves into the factors holding back corporate green investment. The study places specific emphasis on the role of firm capacity, examining both financing constraints and weak green management practices, and their interaction with environmental policies. Our cross-country analysis focuses on the response to a survey of over 6.500 large, listed companies, which are more strictly regulated, across 33 countries between 2004 and 2020. This is complemented by a case study analysis based on disaggregated and comprehensive data available for Portuguese firms between 2010 and 2020. Our research aims to contribute valuable insights to boost green investments toward meeting the ambitious targets set for 2050.

What determines corporate green investment?

Our cross-country analysis shows that in OECD countries both financing constraints and a lack of green managerial capacity reduce firms' probability of investing in green technologies, leading to higher emission intensity. Specifically, becoming financially constrained increases a firm's probability to invest by 2.5 percentage points, around 8% of the average probability (Figure 1, Panel A, first column). In turn, introducing a green management practice, for example by creating a team with green functions, is associated with an increase in the probability to invest (Figure 1, Panel B, first column).

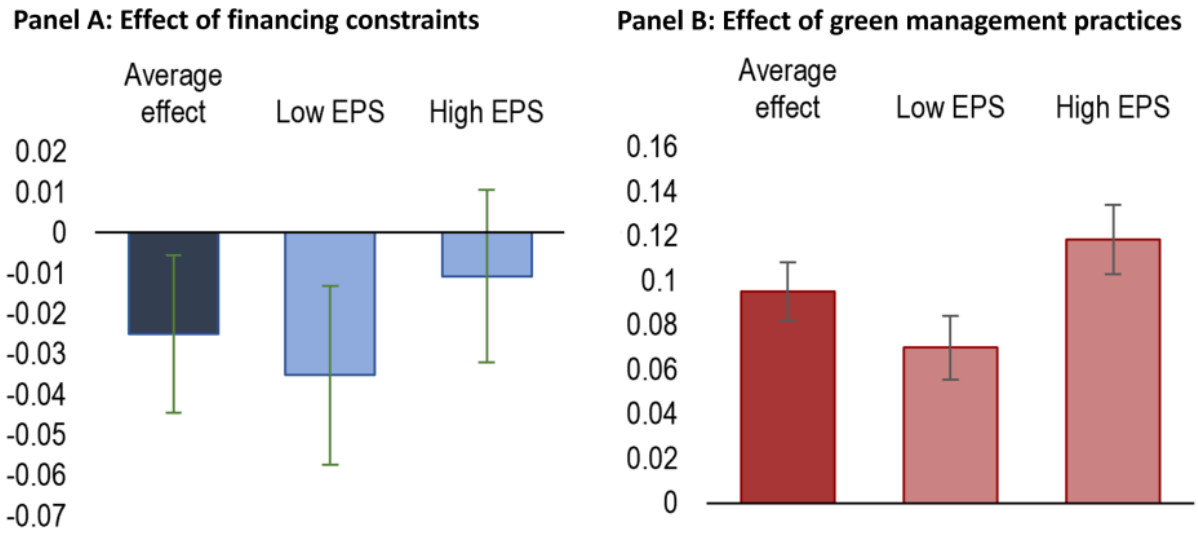
While it is known from previous research that all investment

tends to respond negatively to financing constraints (Kalemli-Özcan et al., 2022), our case study shows that green investment is more elastic to financing conditions than other types of investment. Within green investment, we find that investment in integrated technologies is more sensitive to financing conditions than end-of-pipe solutions, possibly because it is performed less often and primarily to comply with regulation and its costs are less easily measured.

How does firms' capacity interact with policy?

The impacts estimated are toned down in the presence of well-designed environmental policies. Specifically, stringent market-based environmental policies countervail the negative effects of financing barriers on green investment. This is possibly because such policies may incentivise firms to prioritise green investments which would otherwise not be undertaken due to financing constraints. In addition, the positive effect of green management practices is larger the more stringent non-market environmental policies are (Figure 1 Panel A) and the more generous public support is (Figure 1 Panel B). This indicates that green management capacity may help firms to deal with the complexity of non-market-based regulations and government support.

Figure 1: Firm capacity and environmental policy jointly affect green investment



Note: The bars represent the estimated coefficients and the green whiskers the 90% confidence intervals. Panel A: Financial constraints are firms within the highest quartile of the SAFE indicator at NACE2 rev.2 – year; Panel B: The indicator of green management practices is equal to 0-1-2 for firms adopting respectively 0, 1 or 2 green management practices (having a dedicated green team or providing green training to staff).
Source: OECD calculations based on Refinitiv ESG data matched to Orbis 2004-2020.

These results offer valuable insights for policy makers wishing to progress towards their decarbonization goal by promoting private investment. Our paper discusses a menu of policy options that may foster the green transition by upgrading firms' capacity. These include actions to ease financing constraints both at the banking and equity market levels, and actions to improve monitoring tools such as ESG standards which help investors assess firms' greenness and exposure to transition risks, as well as actions to improve environmental management, and complementary signals through strong and predictable climate policy.

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Turning the page on the pandemic in France: Towards

stronger, more inclusive and greener growth

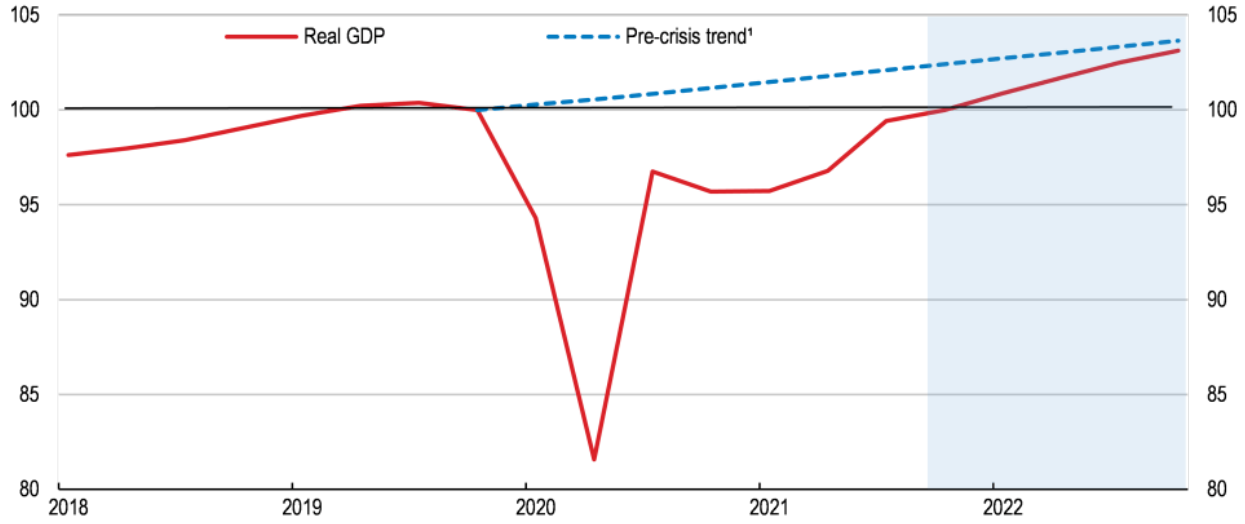
Category: France,Green growth
written by oecdecoscope | March 6, 2024

By Antoine Goujard and Priscilla Fialho, OECD Economics Department

How to sustain the recovery in France and achieve stronger, more inclusive and greener growth than before the pandemic? The expected economic rebound is rapid: GDP and employment reached their pre-crisis levels in the third quarter of 2021 and the French growth is projected to reach 6.8% in 2021 and 4.2% in 2022 (Figure 1). A rapid and effective economic policy response, combined with the massive acceleration of the vaccination campaign, has helped to limit job losses and bankruptcies in 2020 and 2021.

Figure 1. The economy is rebounding rapidly

Index 2019Q4=100



The projections from November 2019 are extrapolated to 2022 using the average potential output growth in 2020-2021.
Source: OECD (2021), OECD Economic Outlook: Statistics and Projections (database), and updates.

However, the short-term risks are significant and the COVID-19 crisis has highlighted some structural weaknesses of the French economy, particularly in terms of education, training and skills, as well as business digitalisation. Indeed, before the crisis, per capita income gains had lagged the euro area average. In the medium term, the high level of public debt combined with public expenditures that are too largely oriented towards pensions risks to weigh on more productive spending such as investment and education, and on the stabilisation of activity in the event of a new crisis.

France is facing a historic opportunity. The recovery plan ("France Relance") and the investment plan ("France 2030") will inject EUR 134 billion (or more than 5% of GDP) towards a more digital and greener economy. The **OECD Economic Survey of France 2021**, published on November 18, 2021, shows that it is necessary to reform the budgetary framework, in particular to strengthen the efficiency of public spending. It is also essential to continue to stimulate employment and job quality, to strengthen efforts to move towards a greener economy, and to ensure that the gains of these reforms benefit the poorest households.

I. Strengthening the public finance framework and spending

effectiveness

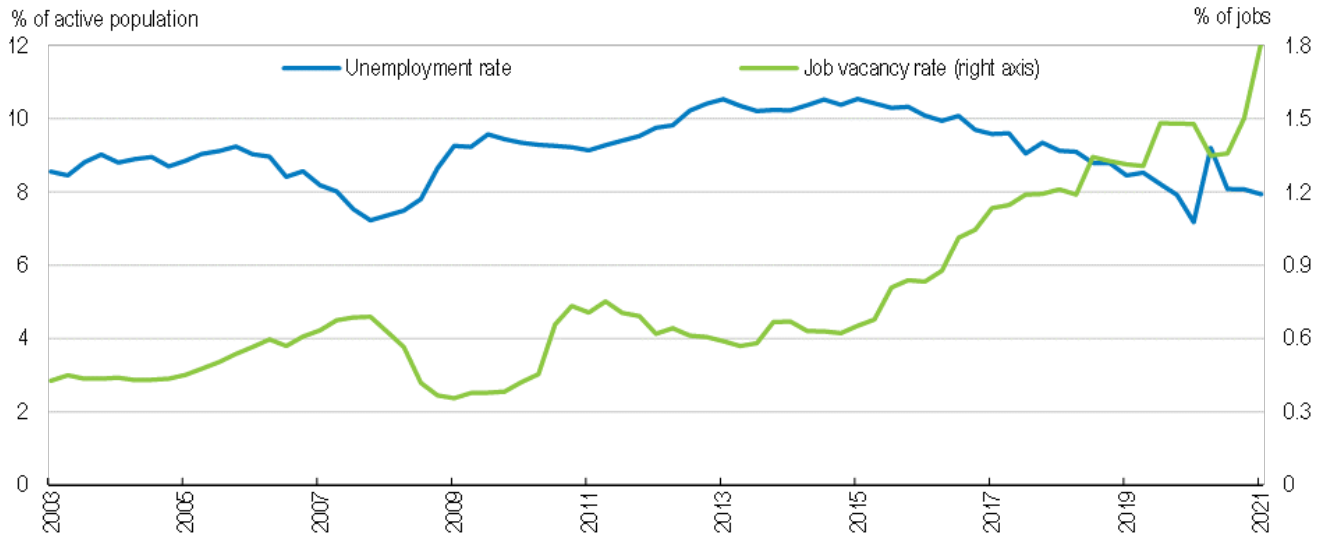
The level of public spending reached 62% of GDP in 2020 and their structure is mainly oriented towards pensions and the wage bill, while education or investment spending are closer to the OECD average, without demonstrating satisfactory effectiveness. The OECD PISA assessments, for example, show a decline in student performance.

Strengthening the fiscal framework must be a priority. The fragmented governance of public finances does not allow a comprehensive assessment of some policies. A multi-year expenditure rule applying to the entire general government, and the implementation of which would be assessed by the French fiscal council (High Council of Public Finances – HCFP), would allow to better manage public expenditures. In addition, the publication of long-term debt projections would raise citizens' awareness of the issues related to its sustainability.

II. Strengthening skills over the life course

A high unemployment rate coexists with increasing labour market tensions (Figure 2). The training plan targeted at recruitment tensions ("plan de réduction des tensions de recrutement") announced in September 2021 is crucial to support the recovery and the labour market reforms undertaken since 2017 are welcome (OECD, 2019). However, the geography of educational disparities and access to employment is very unequal and persistent, especially within large metropolitan areas where income inequalities are significant (Dherbécourt C., 2015; Goujard and Loriaux, forthcoming), which hinders growth and more equal opportunities.

Figure 2. Vacant jobs are increasing despite a high level of unemployment



Source: Dares (2021), Vacancies in the second quarter of 2021; Insee (2021), Unemployment according to the ILO definition.

Early childhood education is essential to reduce inequalities of opportunity. Disadvantaged households must have greater access to formal childcare arrangements. Reducing the risk of dropping out of school is also crucial for growth, as well as for reducing the too large number of young people not in employment, education or training "NEETs". In this sense, the announced "Youth Engagement Contract" ("Contrat d'Engagement Jeune") is an important step and will have to combine effectively enhanced activation and training measures with integration through employment. Strengthening the share of work-based training for apprentices would also help to develop further apprenticeship.

Lifelong learning should improve to enable digital transformations and longer careers. The adoption of new digital technologies is lagging behind in many small businesses that need support to train their workers. In addition, the effective age of labour market exit is the second lowest in the OECD, while life expectancy at 65 is among the highest. Raising the minimum retirement age based on life expectancy must go hand in hand with efforts to train and adapt working conditions to promote the employment of older workers.

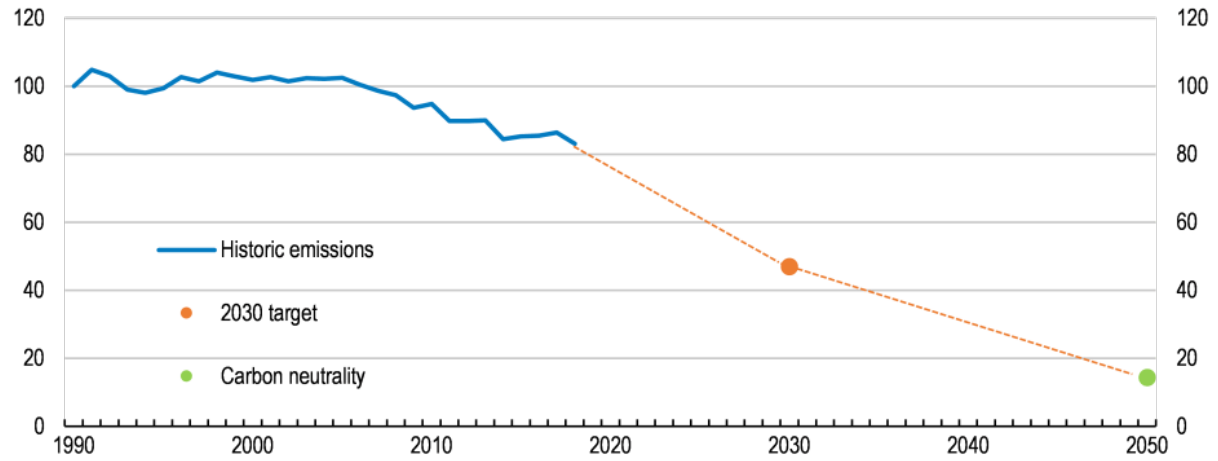
III. Ensuring a fair and efficient transition towards a green

economy

The transition towards a greener economy is essential for more sustainable and resilient growth. France must rapidly reduce its greenhouse gas emissions to meet the challenges highlighted by the COP26 and comply with its commitments (Figure 3).

Figure 3. The pace of emissions cuts must increase

Index 1990=100[1]



Note: The objectives are OECD estimations.
Source: European Commission, Energy Data (database).

Private green investments and the behaviour of households and businesses are key. The 2019 Energy and Climate Law and the Climate and Resilience Law pave the way for better governance of environmental policies, but social acceptability remains critical, as shown in recent OECD work (Dechezleprêtre et al., forthcoming).

A plan that is comprehensive, multi-annual, regularly evaluated and revised as needed, must be effectively put in place. Leveraging all available instruments is key for the transition. Gradually removing exemptions and reduced rates on environmental taxes, in a fair and equitable manner, would strengthen their incentives. To ensure its social acceptability and a socially fair transition, the carbon tax

should be accompanied with complementary support measures targeted at the most vulnerable households and firms.

Sectoral policies must address the major sources of greenhouse gas emissions: transport, buildings and agriculture. In the transport sector, making the eligibility criteria for the conversion premium and the ecological malus scale more stringent would encourage the purchase of greener vehicles. Concerning buildings, conditioning public support for energy renovation to a minimum energy efficiency standard and tightening controls on major projects would increase its the efficiency. Finally, support for the agricultural sector should be reallocated towards payments for agro-environmental services.

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Tourner la page de la pandémie en France: vers une croissance plus forte, plus inclusive et plus verte

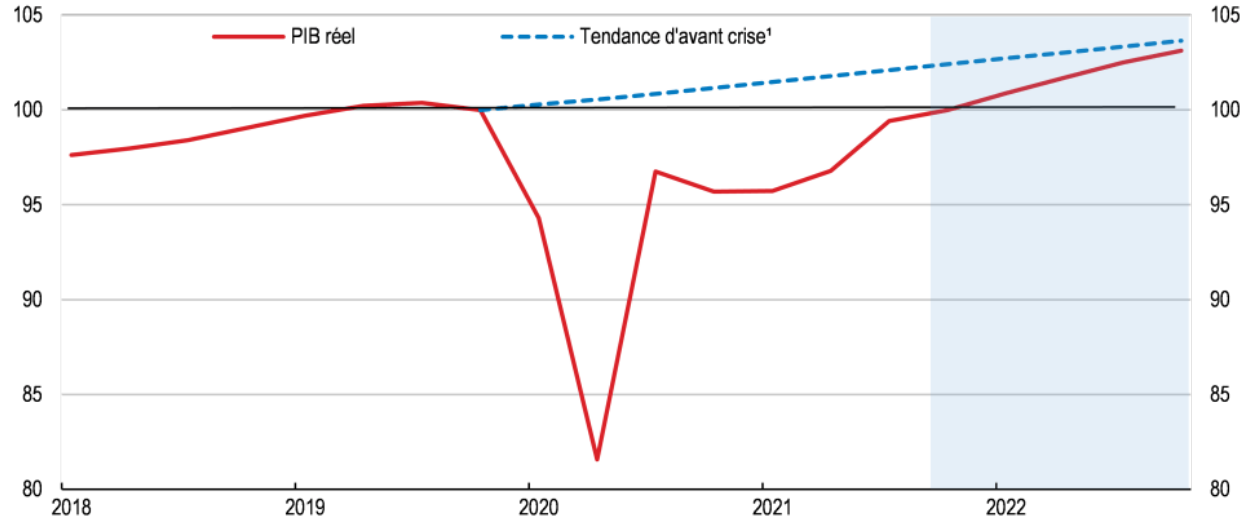
Category: France,Green growth,Posts in French
written by oecdecoscope | March 6, 2024

par Antoine Goujard et Priscilla Fialho, Département économique de l'OCDE

Comment pérenniser la reprise en France et parvenir à une croissance plus forte, plus inclusive et plus verte qu'avant la pandémie ? Le rebond économique attendu est rapide : le PIB et l'emploi ont atteint leurs niveaux d'avant crise au troisième trimestre 2021 et la croissance française devrait atteindre 6.8% en 2021 et 4.2% en 2022 (graphique 1). Une réponse des politiques économiques rapide et efficace, combinée à l'accélération massive de la campagne vaccinale, ont permis de limiter les pertes d'emplois et les faillites d'entreprises en 2020 et 2021.

Graphique 1. La reprise est rapide

Indice 2019T4=100



1. Les projections de novembre 2019 sont prolongées en 2022 par la croissance moyenne du PIB potentiel en 2018-21.
Source : OCDE (2021), Perspectives économiques de l'OCDE : statistiques et projections (base de données) et mises à jour.

Cependant, les aléas à court terme sont importants et la crise liée à la pandémie a mis en avant des faiblesses structurelles de l'économie française, notamment en termes de formation et de qualification et de digitalisation des entreprises. En effet, avant la crise, le revenu par habitant avait progressé moins vite que dans la moyenne de la zone euro. À moyen terme, le niveau élevé de la dette publique combiné à des dépenses trop largement orientées vers les retraites risque d'être un frein aux dépenses plus productives comme l'investissement et l'éducation, et à la stabilisation de l'activité en cas de nouvelle crise.

La France est face à une opportunité historique. Les plans de relance (« France Relance ») et d'investissement (« France 2030 »)injecteront 134 milliards d'euros au total (soit plus de 5% du PIB) vers une économie plus numérique et plus verte. L'Étude économique de l'OCDE : France 2021, publiée le 18 novembre 2021, montre qu'il est nécessaire de réformer le cadre budgétaire, notamment pour renforcer l'efficacité des dépenses, de continuer à stimuler la croissance d'emplois et leur qualité, de poursuivre les efforts vers une économie plus verte et de faire en sorte que les gains de ces réformes bénéficient aux ménages les plus modestes.

I. Renforcer le cadre et les évaluations des finances publiques

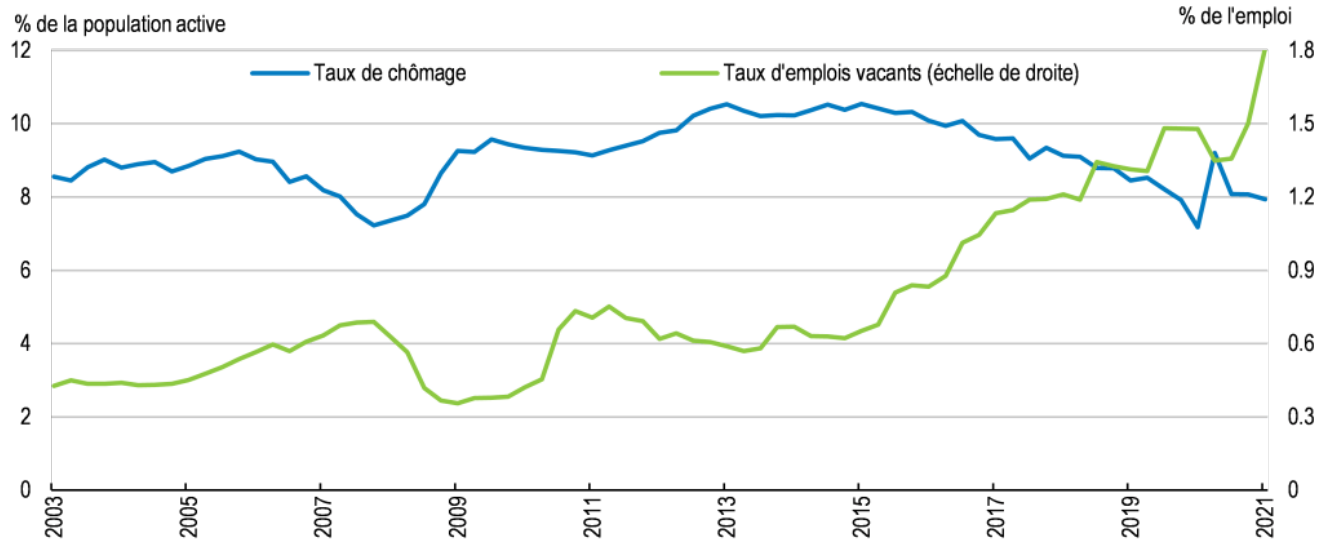
Alors que le niveau des dépenses publiques a atteint 62% du PIB en 2020, leur structure s'oriente principalement vers les retraites et la masse salariale, alors que les dépenses d'éducation ou d'investissement sont plus proches de la moyenne des pays de l'OCDE, sans faire preuve d'une efficacité satisfaisante. Les évaluations PISA de l'OCDE montrent par exemple une baisse de la performance des élèves.

Renforcer le cadre budgétaire doit être une priorité. La gouvernance fragmentée des finances publiques ne permet pas une évaluation complète de certaines politiques. Une règle de dépenses pluriannuelle s'appliquant à l'ensemble du secteur public, et dont la mise en œuvre serait évaluée par le Haut Conseil des finances publiques (HCFP), permettrait une meilleure coordination des dépenses. En outre, la publication de projections de dette à long terme permettrait une sensibilisation des citoyens aux enjeux liée à sa soutenabilité.

II. Développer les compétences tout au long de la vie

Un taux de chômage élevé coexiste avec des tensions croissantes sur le marché du travail (graphique 2). Le plan « de réduction des tensions de recrutement » annoncé en septembre 2021 est crucial pour accompagner la reprise et les réformes du marché du travail entreprises depuis 2017 sont bienvenues (OCDE, 2019). Cependant, la géographie des disparités éducatives et d'accès à l'emploi s'avère très inégale et persistante, notamment au sein des grandes métropoles où les inégalités de revenus sont importantes (Dherbécourt C., 2015 ; Goujard et Loriaux, à paraître), ce qui entrave la croissance et l'égalité des chances.

Graphique 2. Les emplois vacants augmentent malgré un chômage élevé



Source : Dares (2021), Les emplois vacants au 2ème trimestre 2021; Insee (2021), Chômage au sens du BIT.

L'éducation dès le plus jeune âge est essentielle pour réduire les inégalités des chances. Les ménages défavorisés doivent avoir un accès plus large aux modes de garde formels. Réduire les risques de décrochage scolaire est aussi crucial pour la croissance de demain, ainsi que pour réduire le trop grand nombre de jeunes ni en emploi ni en formation (« NEETs » selon l'acronyme anglo-saxon). Dans ce sens, le « Contrat d'Engagement jeune » annoncé est une étape importante et devra assortir mesures d'activation et de formation renforcées avec insertion par l'emploi. Le renforcement de la composante de formation en entreprise permettrait aussi de développer encore l'apprentissage.

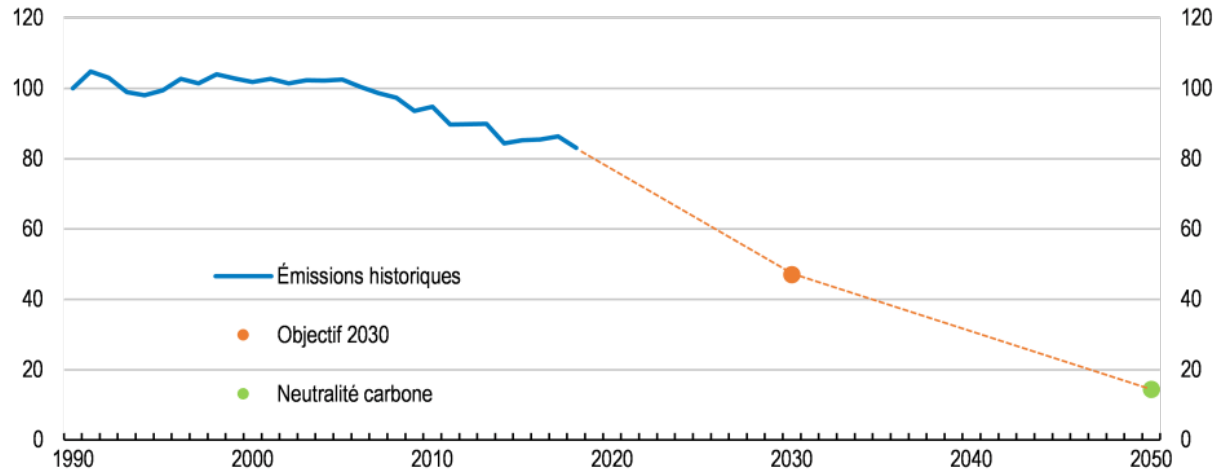
La formation continue doit progresser pour permettre les transformations numériques et l'allongement des carrières. L'adoption des nouvelles technologies numériques est à la traîne dans de nombreuses petites entreprises qui ont besoin de soutien pour former leurs salariés. De plus, l'âge effectif de sortie du marché du travail est, quant à lui, le second plus bas de l'OCDE alors que l'espérance de vie à 65 ans est parmi les plus élevées. Relever l'âge minimum de départ à la retraite en fonction de l'espérance de vie doit aller de pair avec des efforts de formation et d'adaptation des conditions de travail pour favoriser l'emploi des seniors.

III. Mettre en œuvre une transition écologique juste et efficace

La transition écologique conditionne une croissance durable et résiliente. Pour répondre aux enjeux soulignés par la COP26 et respecter ses engagements climatiques, la France doit baisser rapidement ses émissions (graphique 3).

Graphique 3. Les émissions doivent diminuer rapidement

Indice 1990=100[1]



1. Les objectifs représentés sont des estimations de l'OCDE.
Source : Commission Européenne, Données Énergie (base de données).

Les investissements verts privés et les comportements des ménages et des entreprises sont clés. La Loi de 2019 relative à l'énergie et au climat et la Loi Climat et Résilience ouvrent la voie vers une meilleure gouvernance des enjeux climatiques, mais les enjeux d'acceptabilité sociale sont cruciaux, comme le montrent les travaux empiriques récents de l'OCDE (Dechezleprêtre et al., à paraître).

Un plan d'ensemble, multi-annuel et régulièrement évalué et si nécessaire révisé doit être effectivement mis en place. Tous les instruments disponibles doivent être mobilisés pour la transition. Supprimer progressivement les exonérations et les taux réduits sur les taxes environnementales, de façon juste et équitable, renforcerait l'effet incitatif de ces taxes.

Pour assurer son acceptabilité sociale et une transition juste, la taxe carbone pourra aussi être accompagnée de mesures de compensation pour les ménages les plus modestes et les entreprises les plus exposées

Des mesures ciblées doivent aussi s'attaquer aux plus grandes sources d'émissions de gaz à effet de serre: les transports, les bâtiments et l'agriculture. Du côté des transports, les critères d'éligibilité à la prime à la conversion et du barème du malus écologique doivent être renforcés pour encourager l'achat de véhicules moins polluants. Concernant les bâtiments, l'efficacité des aides à la rénovation énergétique doit être améliorée en les conditionnant à un minimum d'efficacité énergétique et à davantage de contrôle pour les grands chantiers. Enfin, le soutien au secteur agricole doit être réaffecté vers les paiements pour services agro-environnementaux.

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The time for reform is now to respond to global challenges

Category: Green growth,Structural reform,Uncategorized
written by oecdecoscope | March 6, 2024
by Laurence Boone, OECD Chief Economist

Globalisation, digitalisation, ageing and environmental degradation are the megatrends shaping tomorrow’s living standards and well-being. The prospects look weak in the absence of renewed reform dynamism. The global economy is facing further headwinds, with growth weakening in the wake of high trade uncertainty. At the same time, gains in living standards, as measured by GDP per capita, have been much slower since the Great Financial Crisis. All this should prompt policy makers to implement necessary reforms to deliver on stronger, more inclusive and environmentally-sustainable growth and help people make the most out of opportunities created in this new world.

This 2019 *Going for Growth* edition offers policy makers a set of country-specific reform priorities to prepare for the future and turn mega-trend challenges into opportunities, for all.

Governments are increasingly addressing social challenges and reforms are paying off

Looking back at reform achievements over the past two years

gives a contrasted picture. Although the overall pace of reforms has returned to the modest pre-crisis pace, a number of countries have managed to implement major reforms – reforms that respond directly to past *Going for Growth* priorities.

Significant examples include reforms to lift employment and make the labour market more inclusive. France improved collective wage bargaining and legal certainty for dismissals, reformed the rules for unemployment insurance and increased in-work benefits. Japan took steps to improve childcare provision and new laws on overtime work to improve work-life balance.

Regulatory simplification and tax policy have also been used to support firms' investment and growth, but also provide governments with necessary resources for redistribution. The United States has cut corporate income tax rates and reformed business taxation – a long-standing *Going for Growth* priority. India implemented a landmark tax reform with the introduction of its Goods and Services Tax. Other countries, such as Greece, Poland and Spain took significant measures to improve tax collection. Several countries took measures to facilitate firm entry and level the playing field for businesses by reducing red tape, deregulating professional services and network sectors as well as by reinforcing competition authorities.

Governments have also intensified reform efforts to tackle social challenges. Greece and Italy rolled-out nationwide anti-poverty schemes. India finalised the connection of all its villages to electricity and launched a national health protection scheme targeting 100 million poor families. China made progress on bridging the rural-urban divide in its health care system by increasing the portability of health insurance.

These reforms are already improving the lives of millions. Yet,

there is more to do, and *Going for Growth* reflects OECD's expert judgement on where policy makers need to focus reform actions to deliver sustainable and inclusive growth for future generations.

More needs to be done, especially on reforms that ensure stronger and fairer outcomes

The reform priorities to boost inclusive growth differ across countries. Education is the most common reform priority and is crucial to make sure current and future generations find employment, which would both boost productivity and give everyone the best chance for a fulfilling life. A significant number of recommendations in the area of education focus on improving the targeting of resources to disadvantaged students and schools, for example in many European and Latin American countries, as well as the United States. Upgrading school infrastructure is a recommendation in emerging-market economies such as India and South Africa.

Both growth and equal opportunities will also benefit from addressing labour market segmentation and improving the labour market inclusion of women, migrants, minorities and older workers – another set of top *Going for Growth* priorities, in particular in Europe, but also in the United States, Japan and several emerging-market economies..

Tax reform, with increasing reliance on property taxation, is a pro-growth priority in many, particularly advanced economies. Better public sector efficiency, rule of law and adequate, accessible infrastructure provision are equally important to save resources, access markets and create conditions for businesses to invest in innovation, in particular, but not only

in emerging-market economies.

Where countries have tended to lag behind is product market reforms. Reforms are often difficult and granular in implementation, but opening up markets to entry, competition and foreign trade and investment are essential for innovation, the diffusion of digital technologies and ultimately productivity growth and social inclusion. Such reforms remain among the most frequent *Going for Growth* priorities.

Going for Growth guides policy makers where to focus their reform efforts for the well-being of their citizens and to achieve strong, sustainable, balanced and inclusive growth. However, some priorities require a co-ordinated effort by all countries. Examples include trade openness, intellectual property rights, taxation of multinational enterprises, migration, climate change, oceans and waste. As such, they are a useful reminder of the benefits of multilateral co-operation.

Growth has to be environmentally sustainable

Responding to the urgency of climate change and to the Paris agreement, this edition of *Going for Growth* includes an environment sustainability angle for the first time. Around the world, environmental pressures are mounting, posing a threat to the sustainability of gains in growth and well-being. Tackling air pollution, climate change and other key environmental problems have to be part of a sustainable growth strategy. As a result, most countries, including key global polluters, have reform priorities and recommendations that address both growth and environmental bottlenecks.

The time for reform is now, for better lives today and for

future generations!

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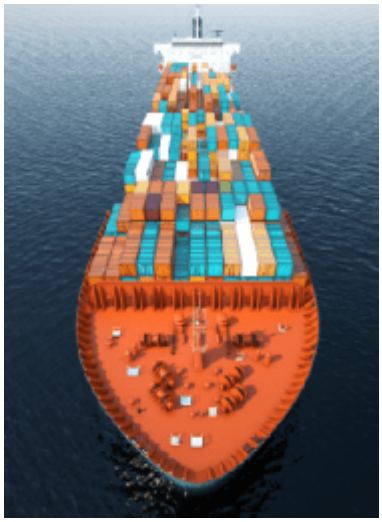
Pollution Havens – just a delusion?

Category: Environment,Green growth,trade
written by oecdecoscope | March 6, 2024



by Christina Timiliotis, Junior Trade Policy Analyst, OECD Trade & Agriculture Directorate, and Tomasz Kozluk, Head of the Green Growth Workstream, OECD Economics Department

Governments in the OECD and elsewhere must intensify efforts to mitigate pollution levels, if the international agreement of the latest COP 21 – pledging to keep global warming below 2 degrees – is to be more than just a loose promise. Against this background, policy makers need to enforce environmental regulations that oblige firms to account for the impact their actions have on the environment, and increase the price of using the environment as a factor of production. While there is broad support for environmental goals in the first place,

support dwindles when compliance with such regulations implies higher production costs.

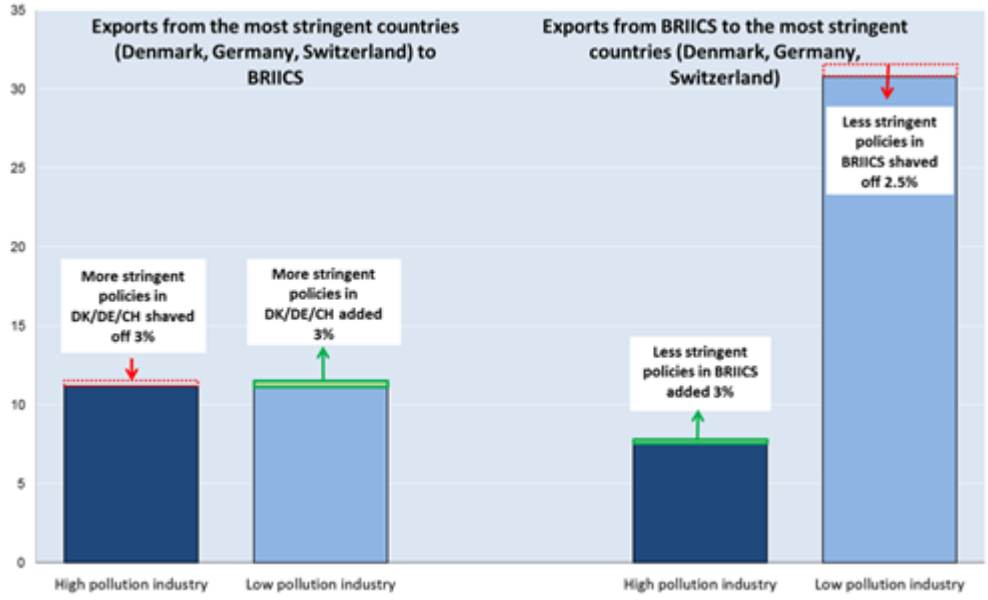
Efforts to put a cost on pollution have indeed often provoked resentment and resistance by producers and workers who fear to be put at a disadvantage *vis-à-vis* foreign competitors that are located in jurisdictions with laxer environmental policies. The conventional wisdom that tougher environmental regulations ultimately entail a loss in competitiveness and thus encourage industries to relocate production to a more favorable business environment, is commonly referred to as the "Pollution Haven Hypothesis" (PHH). If real, it can make environmental policy making politically difficult due to voters resistance and ineffective due to leakage. However, in spite of the PHH's popularity, the evidence behind it is fragmented and to a large extent anecdotal.

The working paper "Do environmental policies affect global value chains? A new perspective on the pollution haven hypothesis" attempts to change this by looking at the Pollution Haven Hypothesis through a new lens, using trade in value added data that more accurately represents today's trade flows in the context of internationally fragmented value chains.

Scrutinising data across more and less pollution intensive industries in 23 OECD countries and six emerging economies since the 1990s, we find that countries with relatively stringent environmental laws do not suffer from lower exports as a result (see compare your country data viz) . There is however, a small effect on their relative competitiveness across different sectors in the economy. In countries with more stringent policies, exports of pollution and energy intensive sectors, such as steel-making or chemicals are lower than in the absence of stringent environmental policies (Figure 1). However, this is compensated by a corresponding increase in exports in "cleaner" industries like machinery or electronics. Moreover, both the positive and negative effects

of environmental regulations on exports of different sectors have been small so far relative to the effects of other factors, such as market size, globalisation, national endowments or trade liberalisation.

Increase in domestic value added in exports 1995-2008, USD billions



Note: The figure shows exports from the three most stringent countries (Denmark, Germany, Switzerland) to BRIICS and vice versa, in billions USD. Pollution intensive sectors are defined according to methodology described in Kozluk and Timiliotis as ISIC rev. 3.1. 2325: Manufacture of coke, refined petroleum products and nuclear fuel; Manufacture of chemicals and chemical products; Manufacture of rubber and plastics products and 2000: Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials. Less pollution intensive sectors are defined as 2933: Manufacture of machinery and equipment n.e.c.; Manufacture of office, accounting and computing machinery; Manufacture of electrical machinery and apparatus n.e.c.; Manufacture of radio, television and communication equipment and apparatus; Manufacture of medical, precision and optical instruments, watches and clocks; 3637: Manufacture of furniture; manufacturing n.e.c.; Recycling.

In its preface to the General Theory, Keynes said that “the difficulty lies not so much in developing new ideas as in escaping old ones.” A myriad of ideas on how to credibly reduce the incentives to pollute in the long-term already exists. It remains to escape the archaic belief that ensuring environmental protection while maintaining a strong market position is infeasible. Governments must stand up to the environmental challenge and focus on the good design of environmental policies, accompanying framework policies and on the edge they can get from innovation – in order to secure both good environmental and economic outcomes.

Reference:

Koźluk, T. and C. Timiliotis (2016), “Do environmental policies affect Global Value Chains? A new perspective on the pollution haven hypothesis”, OECD Economics Department Working Papers, No. 1282, OECD Publishing, Paris.

Further information:

Environment and trade: Do stricter environmental policies hurt export competitiveness?

Environmental Policies and Economic Performance, OECD Insights blog