Business at OECD (BIAC)

Business at OECD (BIAC) *comments on the paper 'Long-term scenarios update: Incorporating the energy transition" (WP 1, March 23)*

- The paper is an excellent start of the discussion of the growth implications of serious decarbonization policies. It builds on the baseline of the long-term scenarios. Clearly, there are a number of interesting interim results and important follow-up questions. Prominently, the energy transition will slightly reduce potential output in the OECD countries and more substantially in the G20 EMs. The transition will see initially much higher investment which comes at the expense of consumption. Fiscally, there will be a substantial positive revenue effect from effective carbon rates which may be used for either lump-sum or targeted transfers to households as to alleviate the adjustment costs. The modelling concentrates on some 80 per cent of emissions. Including industrial adjustment would increase the output and fiscal implications of the model results. Output costs tend to start small and increase over time as marginal costs rise. In general, cumulative mitigation costs tend to be modest in the OECD world (around 4% in optimal settings) and more substantial in G20 EMs (11%), with European transitions being less costly than the OECD average. The welfare implications are not fully spelled out as modelling the damages from climate change, that would otherwise occur, has not yet been done.
- The modelling highlights the large adjustment in the energy sector in terms of sources of energy and the concomitant efficiency improvements, with very high changes in countries with very low initial efficiency in per capita use.
- The paper rightly addresses the dilemma of collective action. Costs to output increase strongly if carbon mitigation policies are not undertaken simultaneously at a similar level of ambition in major emitting countries. Open European economies, Japan and India face particularly high differences in output costs depending on internationally coordinated or un-coordinated policies.
- The paper also rightly stresses that the costs depend much on the instruments of choice, with carbon pricing, subsidies to decarbonized sources and other instruments having widely diverging cost implications. Given the results from the baseline on fiscal pressure in median OECD countries of around 7¼ percent (and many above 10%), a view towards using fiscally efficient instruments is of paramount importance. More guidance on that topic, also related to the paper on carbon mitigation instruments, would be highly welcome.
- The paper also highlights the benefit of using carbon-based revenues for either lump-sum transfers to households or more targeted transfers in sink with active labour market policies mitigating potential labour market adjustment costs from shifting workers out of "brown" into "green" fields of activity. This is well placed, in particular if the manufacturing sector and agriculture are to be integrated into the analysis.

- Laudably, the authors think that modelling the welfare implications, using the model for country analysis in more detail and integrating non-energy sectors into the exercise are useful next steps.

Comments on the Paper
"How does corporate taxation affect business investment?"

- The paper addresses a serious conundrum in economic policymaking, namely the impact of taxation on aggregate business investment. The paper neatly summarizes the empirical evidence which has become more nuanced and complex over time.
- Starting with the bad news, the paper describes how business investment became sluggish and did not appropriately recover to pre-GFC trends despite a dramatic improvement in the cost of capital in the range of six percentage points, mostly due to declining interest rates yet also to tax cuts. It is still not well understood why standard factors cannot explain the phenomenon. More importantly, large, intangible-intensive, profitable and young firms performed much better on investment than their respective peers on the opposite side of the spectrum but all lost sensitivity to tax changes.
- The design of tax changes in terms of statutory tax rates or allowances matters much in generating a cost-effective increase in investment. Policymakers should make us of those insights in designing pro-investment tax policies with a view towards generating positive externalities. The paper rightly stresses that scope for those efficient approaches might be the highest in countries in which the initial statutory tax level is high and allowances are low, and vice versa. There are limits to administrative complexity, however.

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