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Wolfgang Habla, Kerstin Roeder



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The Political Economy of Mitigation and Adaptation*

Wolfgang Habla[†] Kerstin Roeder[‡]

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Abstract

Climate policies have very uneven effects in terms of their fiscal impact. While mitigation of climate change typically raises revenues, adaptation is costly to the taxpayer, and the more so, the more distortionary the tax system. Moreover, the benefits and costs of mitigation and adaptation vary across generations. In an OLG model with majority voting, we show that even in the absence of international pollution spillovers and strategic considerations, neither mitigation nor adaptation can be expected to be set efficiently. The reason is that voters have incentives to use climate policy as an instrument for redistribution. We find that these incentives depend on the underlying tax system. Furthermore, the chosen mitigation *or* adaptation level may be inefficiently high in a political equilibrium with a distortionary income tax system, although not simultaneously. This finding suggests that a distortionary income tax system favors one policy (mitigation or adaptation) at the expense of the other. The calibration of our model to the German economy reveals that *both* mitigation *and* adaptation are lower than their socially optimal levels.

JEL Classification: D72, D78, H21, H23, Q58

Keywords: Adaptation, Mitigation, Political Economy, Majority Voting, OLG, Environmental Taxes

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[†]University of Gothenburg, Vasagatan 1, SE-40530 Gothenburg, Sweden, Email: wolfgang.habla@gu.se

[‡]University of Augsburg, Universitätsstr. 16, DE-86159 Augsburg, Germany, Email: kerstin.roeder@wiwi.uni-augsburg.de

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