

*Mátyás Kapa*

## **Possible Utopian scenario – Climate protection at the center of economic policy**



### *Summary*

The following study presents some possible points of connection between economic policy and environmental protection, partly through practical examples. It also makes an attempt to outline some measures inspired by an economic policy integrated by climate protection, while keeping in mind the generally accepted macroeconomic goals, and to outline their possible effects. In doing so, it raises the possibility of a concept where climate protection is placed at the heart of economic policy objectives by looking at environmental awareness as a new driver sector to fulfil its economic potential. The article does not aim to be exhaustive; its purpose is only to enrich thinking about economic policy using a specific approach.

**Journal of Economic Literature (JEL) codes:** E61, O13, O44, P48, Q56, Q57

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### INTRODUCTION

Economics and politics can be connected in many ways; sometimes it is difficult to reconcile them. As the famous quote says, „The first lesson of economics is scarcity: There is never enough of anything to satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics” (Sowell, 1993:11). At the same time, economic policy is an essential area for the functioning of modern states. In this context: „economic policy means the views, determinations, regular decisions and actions of the state, which the state - more precisely, the government representing the state - applies to influence the economy and society in order to achieve its economic-social-political goals” (Veress, 2019:16). The classic requirements of economic policy are the stimulation of economic growth, the promotion of

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DR. MÁTYÁS KAPA PhD, associate professor, Eötvös Loránd Tudományegyetem,  
(kapamatyas@yahoo.com).

the financial balance of the budget and foreign trade balance of payments, keeping inflation at a low level, and the ability to continuously carry out structural and development reforms that serve the competitiveness of the national economy (Lentner, 2013:78).

In a narrower sense, economic policy includes the macroeconomic goals of state management and the means to achieve them. First introduced in 1967 by the German Minister of Economy, Karl Schiller, the notion of the magic square (*Magisches Viereck*) is often mentioned among the macroeconomic goals. According to this, economic policy must contribute to stable price levels, high employment levels, foreign trade balance, and continuous and appropriate economic growth. Naturally, these goals often conflict with each other; it is practically impossible to realize all of them at the same time, you can only improve the others at the cost of harming one goal. This is also what the term „magic” refers to. At the same time, a government can set itself several goals. The Swiss economic policy, for example, in addition to the above-mentioned four goals, also formulates the requirement of social equality and environmental protection (Botos, 2013:77).

#### ENVIRONMENTAL PROTECTION AND ECONOMIC POLICY

It can hardly be disputed that one of the biggest challenges of our time is the destruction of the natural environment due to human activity, and accelerated climate change that is closely related to it. For this reason, it is perhaps not surprising that in some countries environmental protection features as one of the goals of economic policy. But what if environmental protection was not just one goal among many, but became the primary goal, and the other goals were subordinated to it? What if we looked at climate change not only as a problem, but also as an opportunity?

A good example of the interrelated positive effects of the measures taken in the field of environmental protection and economic policy is the path taken by Costa Rica in recent decades. The country basically implements a coherent and consistent environmental protection policy with an economic approach which has produced spectacular results. First, the environmental problems caused by agricultural production and deforestation were gradually reduced: afforestation programs were launched, nature conservation areas created, and education related to environmental protection developed (Sanchez, 2018). In 1996, the Costa Rican government introduced the Payments for Environmental Services (PES) Program, which pays farmers to protect watersheds, conserve biodiversity or mitigate carbon dioxide emissions. This program was also supported by the World Bank, but the government financed it mainly from the tax on fossil fuels (Konyon, 2021).

Thanks to the environmental protection measures, tourism, especially ecotourism, has taken off significantly, which now generates a quarter of the country’s income, accounts for a significant share of the GDP, and employs a large number of people (Braun et al., 2015). It should also be emphasized that the income from tourism exceeds that from the sale of the most important agricultural export products (sugar, coffee, and bananas). This clearly shows how environmental protection measures can have a significant impact on the operation of the economy.

In addition to the above, Costa Rica has achieved significant results in the application of renewable energies. The country gradually became independent from foreign energy providers, reaching carbon neutrality in energy production by 2015 (Landy-Gyebnár, 2019). In addition, the production of green energy has become cheaper and cheaper over time. In 2020, 72% of electricity was produced by hydropower plants, supplemented by geothermal power plants (15%), wind power plants (12%), and solar energy and biomass based on organic waste (0.5%) (Zuniga, 2020). The use of renewable energy sources also reduced the expenses of the population, and, as a result of the introduced measures, household energy costs decreased by approximately 21% (Jeki, 2018).

#### CLIMATE PROTECTION AT THE CENTER OF ECONOMIC POLICY

Climate change clearly has a huge impact on daily economic processes (Kovács-Pató, 2014). In this situation, an extremely important question is how to harmonize the operation and dynamics of the economy with ecological systems (York, 2006). One possible answer is to reduce resource use and increase added value in a way that increases business profits. This is what the literature calls the improvement of eco-efficiency, which in this form can also be attractive to the business sector (Szabó, 2006; Harangozó, 2018). Recent research has shown that economic growth can be continuously ensured at the macroeconomic level while reducing negative environmental effects. In recent years, interesting analyses have been published showing that in many countries GDP growth has occurred while reducing the ecological footprint (Szigeti – Tóth, 2015).

Based on what has been described above, we can state that from a practical point of view, it is a legitimate question whether the problem of climate change could be placed at the center of economic policy. Encouraged by this, I will briefly outline a concept. I am investigating whether it is possible to develop an economic policy in which we place the priority of climate protection above the goals of the magic square.

I believe that climate protection can be an important element of economic policy considerations from two points of view.

- On the one hand, if current trends continue, radical economic and social consequences will be upon us within the foreseeable future. Let it suffice here to refer to eroding croplands due to weather extremes, rising sea levels, the challenges burdening the health sector, the possible decline in tourism, and migration. Added to this is the fact that sooner or later we will run out of fossil energy sources and other raw materials. In addition to economic necessities, these processes are also influenced by political decisions.
- On the other hand, we can look at climate protection as a kind of opportunity: it can also become a new driving sector that fulfills economic potential. The question is whether *consumer society* can be transformed into a *society that consumes climate efficiency (environmental awareness)* – along the lines of a useful cause? Here, of course, a lot of attention must be paid to distinguishing the real efforts that realize the synergy of economic and environmental protection aspects from the phenomenon of „greenwashing”.

Let's see what kind of economic policy measures integrated by climate protection, but also realizing the goals of the magic square, could be created in an utopian world, and what their possible consequences are.

- First of all, we should consider division of the various sectors of the economy (even applying differentiation within individual sectors) into three categories based on their relationship to climate change: climate protective, climate neutral and climate damaging. This classification could be the basis for the economic policy assessment of individual sectors (products, and services).
- The question of reforming the tax system for ecological purposes has been addressed by the theoretical and practical specialists of economic policy for decades (Ekins, 1999; Andrews-Speed – Rogers, 1999; Bach et al., 2002; Delgado et al., 2022). Supporters of these reforms want to shift the tax burden from generally useful areas (employment, income, investment) to generally harmful phenomena (pollution, waste production, depletion of resources) (Pataki et al., 2003.). Such a tool is the application of environmental protection taxes. Environmental taxes are defined as taxes whose tax base is a physical unit (or proxy of it) of something that has a proven, specific negative impact on the environment (energy taxes, transport taxes, pollution and resource taxes). They promise a double benefit for society: in addition to the improvement of environmental quality, they can provide resources for revitalizing certain sectors of the economy. In the EU, e.g., Eurostat has been collecting data on revenues from national-level environmental taxes since 1997. According to the latest available data, the share of environmental taxes in total tax revenue in 2020 was 5.57% on average for all EU member states, which means a clear and continuous decrease compared to previous years. This rate was highest in Bulgaria (9.89%) and lowest in Luxembourg (3.62%) (ld. [https://ec.europa.eu/eurostat/databrowser/product/page/sdg\\_17\\_50](https://ec.europa.eu/eurostat/databrowser/product/page/sdg_17_50)).

For my part, I propose a slightly different approach when it comes to restructuring the tax system for climate protection purposes. In my concept, taxes and duties could be levied by sectors based on the categorization mentioned in the previous point, and they would rise depending on how much the given sector threatens climate. By definition, subsidies should also be distributed and provided based on these aspects.

- Discounted value added tax should be applied to climate-friendly substitute products and services; this measure would increase the quantity demanded for such products and services.
- The question may arise of how the application of fiscal methods according to the above would affect competitiveness. In the 1990s, the dominant view was that taxes levied for environmental policy considerations worsened the competitiveness of companies and the national economy by increasing comparative costs. According to this approach, rising costs to producers and rising prices to consumers cause losses that exceed welfare gains. However, it has now become widely accepted that traditional economic policy goals (increasing competitiveness, employment, productivity, national income) and environmental protection considerations can be brought into line by

reinforcing each other. This is partly due to the reinterpretation of the concept of competitiveness. Due primarily to the work of Michael E. Porter (Porter, 1990; Porter, 1991), over time competitiveness came to be identified with the ability to adapt and renew. According to Porter, the basis of a sustainable competitive advantage is the ability to innovate, and scarcity of natural resources (or higher cost of them) encourages businesses to innovate. The resulting innovations can offset the costs imposed by a stricter environmental policy. According to his assumption, therefore, strict environmental policy regulations force companies to innovate, which in the long run improves their own and the national economy's international competitiveness.

- Priority should be given to research, secondary and higher education (retraining) would provide the climate protection industries with appropriate innovations and specialists. This would serve both economic growth, consumption growth and employment.
- Among the monetary instruments, a state-owned, sector-specific development bank could be established, which would specifically provide discounted loans or loan guarantees for fixed capital investments and working capital investments to enterprises operating in the climate protection sectors.
- In the area of real estate financing, preference should be given to solutions that significantly reduce the environmental load during both construction and subsequent operation and utilization (Wan et al., 2022).
- Among state investments, preference should be given to the establishment of plants producing green energy. These require large investments, but pay off over time. They could partly replace traditional construction industry investments. This could have a beneficial effect on both economic growth and employment.
- By applying environmentally conscious solutions during public procurement, the state can also have a significant impact on the economy in several ways. On the one hand, it can stipulate that only companies who meet certain environmental protection requirements can participate in certain public procurements. On the other hand, the state can set environmental protection expectations against the ordered products and services. Finally, it can also plan to purchase environmentally friendly products and services. The latter two solutions can expand the market for climate-friendly products and services, thereby serving the goals of innovation, economic growth and employment expansion (Pataki et al., 2003).
- Cheaper green energy reduces household expenses on the part of the population, and the resulting savings can increase consumption.
- Cheaper green energy in the goods and services market contributes to ensuring price stability. This connection is particularly striking now when runaway energy prices in some countries are fueling inflation on a scale not seen for decades.
- „Climate protection services” should be remunerated with direct payments. Here, the owners of assets and properties that are effective in terms of climate change would receive support for the activities they undertake, which offset the effects of climate change, and are not necessarily profitable on a market basis (e.g. reforestation, or

profile change). For this, a multi-source fund would have to be created, which would also manage and use payments from the beneficiaries of beneficial externalities in addition to subsidies from state and international organizations.

- Direct and indirect methods should be used to direct stakeholders in the direction of the expanding climate protection sectors in the field of public benefit employment and becoming entrepreneurs for the unemployed. Here it is worth referring back to what was explained earlier about the climate-friendly tax system. If the state uses the revenue from additional taxes on sectors, products, and services harmful to the climate to reduce labor costs, this can improve the employment situation. The White Paper on Growth, Competitiveness and Employment published by the European Commission in 1993 already indicated that „if the double challenge of unemployment/environmental pollution is to be addressed, a swap can be envisaged between reducing labour costs through increased pollution charges” (White Paper, 1994:166).
- Some industries, including tourism supported by a country image emphasizing climate awareness, may experience expansion, which would have a positive effect not only on economic growth, but also on employment.
- Changes in the ratio of energy imports and energy exports can have a favorable effect on the country’s balance of payments.

#### CLOSING THOUGHTS

Finally, warning myself to be careful, I would like to close this article with an instructive story.

„A farmer goes to the wiseman and complains that his geese are dying.

- What do you feed them?
- Corn.
- That is the problem! Then feed them grits!

A week later, the farmer complains again that his geese are still dying.

- You are stupid! – says the wiseman. – Feed them oats!

After a few days, the farmer complains again that despite feeding oats to his geese, they still die.

- Why don’t you feed them barley?!
- The next day, the complaining man appears again:
- I tried in vain with the barley, my last goose also died!
  - Now you don’t have a goose?
  - Not a single one.
  - What a pity! I would have had so many other good ideas...”

What is the moral of this story? My article was primarily about ideas, about basics that might be worthy of further thought and further elaboration. This article is not intended to be exhaustive and does not claim to provide a general solution to the world’s great problems. Its purpose was merely to enrich thinking about economic policy with a specific approach.

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