

The behavioural economics of climate change

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Abstract

This paper attempts to bring some central insights from behavioural economics into the economics of climate change. In particular, it discusses (i) implications of prospect theory, the equity premium puzzle, and time-inconsistent preferences in the choice of discount rate used in climate-change cost assessments, and (ii) the implications of various kinds of social preferences for the outcome of climate negotiations. Several reasons are presented for why it appears advisable to choose a substantially lower social discount rate than the average return on investments. It also seems likely that taking social preferences into account increases the possibilities of obtaining international agreements, compared to the standard model. However, there are also effects going in the opposite direction, and the importance of sanctions is emphasized.

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