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A panel data heterogeneous Bayesian estimation of environmental Kuznets curves for CO₂ emissions

Abstract

This paper investigates the environmental Kuznets curves (EKC) for CO₂ emissions in a panel of 109 countries during the period 1959-2001. The length of the series makes the application of a heterogeneous estimator suitable from an econometric point of view. The results, based on the hierarchical Bayes estimator, show that different EKC dynamics are associated with the different sub-samples of countries considered. On average, more industrialized countries show evidence of EKC in quadratic specifications, which nevertheless are probably evolving into an N shape based on their cubic specification. Nevertheless, it is worth noting that the EU, and not the Umbrella group led by US, has been driving currently observed EKC-like shapes. The latter is associated to monotonic income-CO₂ dynamics. The EU shows a clear EKC shape. Evidence for less developed countries consistently shows that CO₂ emissions rise positively with income, though there are some signs of an EKC. Analyses of future performance, nevertheless, favor quadratic specifications, thus supporting EKC evidence for wealthier countries and non-EKC shapes for industrializing regions.

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Keywords: Environmental Kuznets Curve, CO₂ emissions, Bayesian approach, heterogeneous panels

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JEL classification: C23, Q53

1. Introduction

Since the pioneering work of Grossman and Krueger (1995), Shafik (1994) and Holtz-Eakin and Selden (1992) interest in the so-called Environmental Kuznets Curve (EKC) has increased. The EKC hypothesis is that, for many pollutants, relationships between per capita income and pollution show inverted U-shapes, following the more famous original Kuznets hypothesis which has been considered over time in its original and revised forms (Tsakloglu, 1988). Most investigations have focused on major air emissions, though evidence for other externalities like local atmospheric and water emissions, and waste has begun to accumulate¹. In this study we focus on CO₂ emissions, which have been recognized as a major source of environmental pollution. First, CO₂ emissions are directly linked to the production and consumption of energy and, thus, the shape of the relationship between CO₂ emissions and economic development has implications for the definition of an appropriate economic and environmental policy. Second, empirical evidence in support of an EKC dynamics, or delinking between emissions and income growth, has been shown to be more limited and fragile in the case of CO₂ emissions with respect to local air and water pollutants. A decoupling between income growth and CO₂ emissions is not (yet) apparent for many important economies in the world (Vollebergh and Kemfert, 2005); where it is observed, it is a relative rather than the

¹ Waste, which is a very different externality with respect to impacts and local dimension, is the only pollutant other than CO₂ where there is a lack of robust evidence in favour of absolute delinking (Mazzanti and Zoboli, 2005; Mazzanti, 2007; Wang et al., 1998). There is some recent evidence of EKC trends in waste generation (Mazzanti, Montini, Zoboli, 2008a,b).

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3 absolute delinking assumed by the EKC hypothesis (Fischer-Kowalski and Amann,
4
5 2001).
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7 Theoretically based works do not predominate in studies of EKC²
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48 ² A recent seminal paper by Copeland and Taylor (2004) surveys the literature and presents a model
49 in which sources of growth, increasing returns to abatement, income and threshold effects are the
50 main drivers of EKC.
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though some contributions have aimed at establishing some foundations for the empirics of EKC. They generally try to explain EKC dynamics by a preference based technological externality type, and policy factors. Some of these works are worthy of further comment. Andreoni and Levison (2001) is a seminal work that suggests that EKC dynamics may be quite simply technologically micro founded, and not strictly related to growth and externalities issues. Kelly (2003) shows that the EKC shape depends on the dynamic interplay between the marginal costs and benefits of abatement.

Comment [CL1]: Sorry not sure if this is correct

At a more macroeconomic level, Brock and Taylor (2004) integrate the EKC framework with the Solow model of economic growth; they show that this revised model generates an EKC relationship between both flow of pollution emission and income per capita, and the stock of environmental quality and income per capita, with the resulting EKC being either an inverted U shape or strictly declining. Chimeli and Braden (2005) integrate the EKC into a model of total factor productivity. Low levels of income involve high values of discount rate, which are obstacles to the adoption of a pollution abatement policy. Only when the discount rate falls, as a consequence of growth, is it possible to implement measures for emissions reductions, leading to an inverse U-shaped income-pollution pattern.

Notwithstanding the increasing relevance of theoretical studies on EKC, it is the quantitative side of the analysis that has dominated, and nevertheless still provides scope for research improvements at the margins. In fact, with some exceptions which we comment on below, studies using macro-panel data generally assume slope homogeneity across countries, and employ the classic fixed or random effects estimators or the more recent panel cointegration approach.

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With the increasing time dimension of panel data sets, however, a more heterogeneous estimator might be more suitable from an econometric point of view (Pesaran and Smith, 1995; Pesaran *et al.*, 1999; Hsiao *et al.*, 1999).

The paper is organized as follows. In section 2, we review recent developments in EKC analysis for CO₂, focusing on the heterogeneity of panel data estimators. Section 3 describes the econometric framework. Section 4 presents the results of the estimations and section 5 concludes. Data sources and definitions are provided in the appendix.

2. Recent developments in studies of EKC for CO₂

Although there are a large number of studies on CO₂ decoupling of income growth and CO₂ emissions is often not (yet) apparent from the data for many of the important world economies (Vollebergh and Kemfert, 2005); where delinking is observed, it is often of a relative and not an absolute kind, as assumed by the usual EKC hypothesis.

Recent works, on the basis of newly updated data and new techniques, have highlighted that some evidence, even if differentiated by geographical area and by estimation technique, is emerging of a delinking (Martinez-Zarzoso and Bengochea-Morancho, 2004; Vollebergh *et al.*, 2005; Galeotti *et al.*, 2006). Although this evidence is patchy, i.e. heterogeneous across various attempts (which use different data with respect to time span and countries), it can be claimed that, for the OECD countries, some EKC evidence for CO₂ is emerging. The picture is thus slightly more optimistic, counterbalancing to a degree less optimistic views (Harbaugh *et al.*, 2002; Stern, 1998, 2004). However, overall the evidence is far from robust, and

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3 results should be interpreted with care. Though we do not here aim at completely
4 surveying the literature, some recent contributions deserve specific attention.

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7 Cole (2005) recently applied the heterogeneous Swamy random coefficients
8 estimator and concluded that the income-pollution relationship varies widely across
9 countries. This suggests that the assumption of constant coefficients across
10 countries in a traditional fixed-effects specification is inappropriate. More
11 fundamentally, it suggests that there is no income-pollution relationship that is
12 common to all countries, which questions the existence of a general EKC shape.

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15 Most of the existing empirical literature applies pooled panel data estimators to
16 samples of heterogeneous countries. Recent developments in the literature test the
17 robustness of the EKC hypothesis by applying flexible parametric specifications, by
18 exploiting partially or fully non-parametric models, or by looking at the
19 cointegration properties of CO₂ time series (Vollebergh et al., 2005; Galeotti, Lanza,
20 Pauli, 2006), and producing mixed results that do not help to account for the
21 intrinsic EKC empirical fragility. In a nutshell, the main criticisms in recent years
22 have focused on the plausibility of a standard “homogenous” panel in cross country
23 analyses where different income-CO₂ relationships may exist.

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26 Dijkgraaf and Vollebergh (2005) and Vollebergh et al. (2005) allow for both
27 heterogeneity across countries and flexible (non parametric) functional form, and
28 show that traditional panel models with country specific, or country and time
29 effects may present turning points within the observed income ranges; nevertheless,
30 the null hypothesis of slope homogeneity is strongly rejected by the data, thus
31 questioning the existence of an overall EKC and the assumption of homogeneity.

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34 Dijkgraaf and Vollebergh's (2005) paper casts doubt on the EKC results based on
35 homogenous panel estimation. They use the sample of the 24 OECD countries for

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3 1960-1997 and challenge the existence of EKC dynamics for CO₂, at least for the
4 OECD countries. They suggest a more in depth country-specific investigation.
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6 Traditional panel models that include country specific or country and time effects
7 show turning points at around \$14,000-15,000; nevertheless, the null hypothesis of
8 slope homogeneity is strongly rejected by these data. A general model with slope
9 heterogeneity shows a higher turning point (\$20,600). However, all these levels are
10 within the sample range. The most striking result is that time series analysis,
11 compared to heterogeneous panel estimations, presents a different picture. Only
12 five out of 13 countries that showed evidence of an EKC dynamics confirm this
13 outcome. The authors conclude that more work should be done on time series data,
14 assuming there is sufficient availability³.

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16 Vollebergh et al. (2005) explore various parametric and non parametric
17 specifications of a CO₂ dataset of OECD countries and find that EKC shapes are
18 quite sensitive to the degree of heterogeneity included in the panel estimations,
19 indicating the need for further exploration not only using heterogeneous panel
20 specifications, but also more flexible estimation tools. Parametric models generate
21 EKC shapes with quite low turning points, while the evidence for semi parametric
22 estimations is less robust. The non-parametric setting demonstrates the necessity to
23 incorporate heterogeneity, which leads to the exploration of single, country specific
24 time series, and to the suggestion of caution in relation to panel based EKC
25 outcomes, especially if they do not address the heterogeneity issue in some way.
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48 ³ They also point out that for some pollutants, such as CO₂, the lack of homogeneity is not a
49 surprising outcome given the trends in international specialization, differences in local features and
50 absence of strongly coordinated policies at least at the international level.
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4 These authors thus argue that the inverted U shaped curve is likely to exist for
5 many countries (with higher incomes), but not all countries: homogeneity in EKC
6 shapes, therefore, is a too restrictive hypothesis. The existence of an EKC curve, in
7 cross country international framework such as OECD based analysis, may depend
8 on the balance between high income countries showing an inverted U shape
9 dynamics, and high income countries, which present a still positive elasticity for
10 emissions with respect to income. Trying to consider together widely different
11 countries may present difficulties and lead to not easily interpretable and not very
12 useful outcomes for informing policy making, which needs to rely on the
13 assumption of country heterogeneity in costs and performance in order to set
14 efficient and effective allocations.

15
16 Galeotti, Lanza and Pauli (2006) are rather skeptical of the assumption of an EKC,
17 and test the robustness of the EKC hypothesis by analysing CO₂ series. The paper
18 provides mixed evidence, focusing on CO₂ and estimating different specifications
19 based on varying sets of emissions data and the parametric structure of the model,
20 but is optimistic in its conclusions. Robustness is tested on the basis of data
21 typology and on the basis of alternative specification hypothesis. Results show that
22 data sources seem not to affect EKC evidence. By exploiting a flexible parametric
23 model, an inverted U shape curve is found for the OECD countries, regardless of
24 the data source used; for the non-OECD countries the EKC is basically
25 increasingly, but results are more dependent on the data source. Turning points for
26 the OECD countries occur around €16,000 and for the non-OECD countries at
27 between €16,000 and €20,000, which, as expected, demonstrates the less stable
28 relationship between CO₂ and GDP, with respect to the data source.

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4 The papers referred to highlight the role of semi-parametric and fully non-
5 parametric EKC estimations. Taskin and Zaim (2000) use non-parametric
6 production frontier techniques, establishing an EKC relationship using kernel
7 estimation methodology. Both kernel and parametric estimations show an N shape
8 from the data: non-parametric estimations give robustness to the choice of a cubic
9 specification. Turning points for the N shape curve are found at \$5,000 and \$12,000
10 per capita.
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17 Another interesting recent study is by Azoumahou et al. (2006), who use CO₂ data
18 for 1960-1996 for 100 countries, exploiting non-parametric and parametric
19 specifications for comparison. The paper discusses recent evidence from the semi-
20 and non-parametric literature, arguing that functional issues are of more concern
21 than heterogeneity issues. The authors compare various models, finding that EKC
22 shapes emerge from a parametric panel model (signs positive for linear and squared
23 terms, and negative for cubic terms), and that a monotonous relationship emerges
24 from non-parametric settings and first difference regressions.
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34 In light of these recent developments, we argue that, by increasing the time
35 dimension of panel data sets, the choice of a more heterogeneous estimator may be
36 preferred. In this paper, we use heterogeneous panel data estimators, derived from
37 the Bayesian approach. In particular, we apply the “hierarchical Bayes estimator”
38 proposed by Hsiao et al. (1999), which has been shown to be preferable to other
39 heterogeneous panel data estimators (Hsiao et al., 1999; Baltagi et al., 2004).
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We note that we do not control for possible determinants of CO₂ emissions, such
as energy prices or technological change. This is scope for further research. In
addition, as pointed out by Azoumahou et al. (2006) there are reasons for this kind
of econometric specification. The two basic ones are related to data availability over

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3 long time series and many countries in terms of additional covariates, and
4 comparability with existing studies. The third is more econometrically-based:
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6 although a specification that excludes the determinants of CO₂ emissions is not
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8 appropriate ceteris paribus for measuring the impact of GDP on CO₂ emissions,
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10 this kind of econometric specification is very useful for capturing the global effect
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12 of GDP on CO₂ including the indirect effects linked to the omitted variables which
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14 are correlated with GDP.
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18 The specific incremental value added of this paper is twofold. First, we present
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20 evidence on CO₂, exploiting a new method aimed at dealing with country
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22 heterogeneity. This is a methodological advancement. CO₂ is the only emission for
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24 which currently there is sufficient data availability to implement this kind of
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26 quantitative methodology at the international level. Second, in order to provide
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28 more economic and policy meaningful results, we test the EKC hypothesis on sub-
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30 samples of countries (G7, OECD, EU₁₅, non-OECD, poorest countries⁴), and
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32 compare EKC trends with the total sample trend. We share the view that the EKC
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34 hypothesis is not applicable as a general concept, as it was present an overall cross
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36 country dynamic development of the emission-income relationship: many EKC
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38 shapes are possible, depending on the country, the area and the period defined.
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42 3. Econometric framework

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48 ⁴ We argue that this sub-division is useful for deriving policy conclusion in the CO₂ policy arena,
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50 where the reasoning mainly revolves around the role played by different areas according to their
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52 environmental and development path.

3.1 Estimation issues

The fact that the time dimension is allowed to increase to infinity in macro panel data generates two sets of ideas. The first is related to time series procedures applied to panel data to deal with non-stationarity, spurious regressions and cointegration (Kao and Chiang, 2000; Phillips and Moon, 1999). The second rejects the homogeneity of the parameters implicit in the use of a pooled estimator in favour of heterogeneous regressions.

Within this strand of literature and treating the parameters as fixed, it is possible to estimate separate ARDL (Auto-Regressive Distributed Lags) equations for each group and examine the mean of the estimated coefficients – the so-called Mean Group (MG) estimator (Pesaran and Smith, 1995). The MG, however, does not take into account the fact that certain parameters may be the same across groups. Pesaran et al. (1999), therefore, proposed an intermediate estimator, the Pooled Mean Group (PMG) estimator which allows the intercepts, short-run coefficients and error variance to differ across groups, while the long run coefficients are identified by an equality constraint.

Another way of building heterogeneous panel data estimators derives from the Bayesian approach, which treats the parameters as random, and as drawn from some distribution with a finite number of them⁵. Recently, Hsiao and Tahmiscioglu

⁵ Although within the slightly different framework of policy evaluation, we note the work by Brock et al. (2003), who propose model averaging methods as a statistical procedure to tackle model uncertainty. Within this reasoning, based on averaging models using a formalized statistical procedure rather than informal methods, the Bayesian paradigm and statistics (versus Waldian and frequentist) plays a crucial role. Since EKC issues are within the broader realm of empirical macro economics and are to some extent linked to policy evaluation studies, this type of reasoning has

(1997) and Hsiao et al. (1999) proposed the use of Bayes and hierarchical Bayes estimators, building on early work by Lindley and Smith (1972) and Swamy (1970): in fact the Swamy (1970) random coefficients model, motivated by the classical generalized least squares arguments, can also be considered a Bayes estimator.

However, making the choice between fixed and random coefficients formulations, despite the extensive discussion in the literature, is difficult in practice (Hsiao *et al.*, 1995).

In the following, we apply Hsiao et al.'s (1999) hierarchical Bayes approach to the estimation of an ECK for CO₂ emissions. Our choice is motivated by the fact that using both Monte Carlo experiments and an empirical example of a q investment model, Hsiao et al. (1999) find that this estimator is preferable to the other consistent estimators. Moreover, reconsidering the q-investment model and contrasting the performance of 9 homogeneous estimators and 11 heterogeneous and shrinkage Bayes estimators, Baltagi et al. (2004) find that the Hsiao et al. (1999) hierarchical Bayes estimator gives the best performance.

3.2 Econometric model and estimation methodology

relevancy even within this framework. First, model uncertainty, which is discussed at length, is a key pillar of this literature. With or without a formalized theoretical model, the spectrum of empirical models is wide. Within the EKC framework, following the authors' taxonomy of uncertainty, theory uncertainty (e.g. which empirical model, which non-linear assumption), specification uncertainty (e.g. non linearity, number and content of covariates) and heterogeneity uncertainty (data sources, time span, statistical units) as interrelated and overlapping concepts, are relevant. Secondly, more and more studies are analysing the extent to which policies modify the endogenous EKC dynamic (reducing the turning point income level and/or the environmental indicator peak).

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We are interested in the estimation of the mean coefficients of a standard EKC function in the presence of slope heterogeneity across cross-sectional units for our sample of 109 countries for the period 1959-2001. Let us consider the following random coefficients specification:

$$(1) \quad y_i = X_i \theta_i + u_i, \quad i = 1, \dots, N$$

where $y_i = (y_{i1}, y_{i2}, \dots, y_{iT})'$ is the $(T \times 1)$ vector of observations for the dependent variable ($y_i = \ln(\text{CO}_2)$), namely the logarithm of CO₂ emissions per capita, and $X_i = (x_{i1}, \dots, x_{iT})'$ is a matrix of dimensions $(T \times k)$ of the explanatory variables for the i 'th cross-sectional unit. If we are interested in the estimation of a cubic formulation for the ECK, we obviously obtain a $(T \times 3)$ matrix of explanatory variables, given by: $X_i = (\ln y_i, (\ln y_i)^2, (\ln y_i)^3)$ where y is GDP per capita.

The central assumption of the random coefficients formulation is that $\theta_i = \bar{\theta} + \varepsilon_i$ where the ε_i are independently normally distributed with mean 0 and covariance Δ , i.e. $\theta_i \sim IN(0, \Delta)$ and $Cov(\theta_i, \theta_j) = 0$ if $i \neq j$. Each regression coefficient can thus be considered a random variable with a probability distribution. The random coefficients formulation reduces the number of parameters to be estimated, while still allowing the coefficients to differ across countries.

Additional assumptions are that: i) the disturbances are heteroskedastic and uncorrelated across different cross-sectional units, i.e. $u_i \sim iid(0, \sigma_i^2)$ and

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4 $Cov(u_i, u_j) = 0$ if $i \neq j$; ii) the explicative variables are strictly exogenous, i.e. X_{it}
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6 and u_{it} are independent for all t and s .
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9 From a Bayesian point of view, Hsiao et al. (1999) focus on the inference of the
10 mean coefficient vector, $\bar{\theta}$ conditional on y , and the underlying model M ,
11 summarized in the posterior density $p(\bar{\theta}|y, M)$. The observations in y define a
12 mapping from the prior $p(\bar{\theta})$ into $p(\bar{\theta}|y, M)$. When there is reliable prior
13 information on Δ and σ_i^2 , the posterior distribution of $\bar{\theta}$ can be derived by
14 expressing the likelihood function conditional on the initial values y_0 and
15 combining it with the prior distribution of $\bar{\theta}$:
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$$(2) \quad p(\bar{\theta}|y, y_0) \propto p(y|\bar{\theta})p(\bar{\theta}).$$

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32 Lindley and Smith (1972) discuss the derivation of the Bayes estimator of $\bar{\theta}$: they
33 propose a three-stage hierarchical method. The first stage of the hierarchy
34 corresponds to the joint density function of y_i . Following the previous
35 assumptions we can write:
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$$(3) \quad p(y_i | X_i, \theta_i) \propto N(X_i \theta_i, \Omega_i)$$

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47 where Ω_i is a block diagonal matrix given by $\Omega_i = \sigma_i^2 \mathbf{I}_T$. The second stage is
48 defined as the density function of the vector of parameters θ_i :
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$$(4) \quad p(\theta_i) \propto N(\bar{\theta}, \Delta),$$

and the third stage corresponds to the prior distribution of $\bar{\theta}$:

$$(5) \quad \bar{\theta} \propto N(\varphi, \Psi).$$

These three stages allow us to derive the posterior distributions of the unknown parameters. Prior distributions for nuisance parameters, however, lead to integrals that cannot be expressed in closed form. Consequently, Lindley and Smith (1972) propose a naïve approximation, based on using the posterior distribution mode rather than the mean. However, as a result of recent advances in sampling-based approaches to calculating marginal densities, a full Bayesian implementation of this model is now feasible. In particular, Hsiao et al. use the Gibbs sampling approach proposed by Gelfand and Smith (1990) which is an iterative Markov chain Monte Carlo method that only requires knowledge about the full conditional densities of the parameter vector.

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4. Empirical evidence

4.1 Preliminary tests

We first consider the issue of slope homogeneity across countries. For this, we focus on Swamy's (1970) random coefficients model and apply the χ^2 test statistic suggested by Swamy (1971) to test the null hypothesis of coefficients constancy across countries. This test is based on the differences between the OLS estimates, equation by equation, and the weighted average of the OLS estimates. The results

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3 strongly support the hypothesis of slope heterogeneity across cross-sectional units.
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5 Thus, while the aggregation on sub-areas is inspired by heterogeneity in institutional
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7 and policy related factors, the econometric analysis points strongly to the need to
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9 apply heterogeneous estimators in the panel setting.

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11 Assuming slope heterogeneity we apply the hierarchical Bayes estimator. Table 1
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13 summarizes our estimates of $\bar{\theta}$ obtained from the estimation of equation (1),
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15 highlighting the average shape of the income-carbon dioxide relationship and the
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17 eventual turning point, taking into account both a non-limited income range and the
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19 observed income range. In line with the literature, we consider both a quadratic and
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21 a cubic specification.

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23 The hierarchical Bayes estimator requires prior information on the distribution of
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25 the coefficients. For this, we use the results obtained from the Swamy (1970)
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27 random coefficients regression estimator, which is a weighted average of the
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29 individual least squares estimates where the weights are inversely proportional to
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31 their variance-covariance matrices.

32 33 34 35 36 37 **4.2 Main outcomes**

38 39 **4.2.1 Quadratic specifications**

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41 The results are as follows. First, regarding the quadratic specifications, the inverted
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43 U shape is validated for the full sample of countries, but not within the observed
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45 income domain, while for three of the five sub-samples (G7, EU15, OECD) the
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47 EKC hypothesis is robust. Turning points are found for more developed areas in
48
49 the range \$14.688 and \$18.607 per capita (Table 1 shows observed income ranges).

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3 The non-OECD and poorest countries, consistent with *a priori* expectations, show
4 the reverse EKC picture. A monotonic increase in emissions with respect to GDP
5 is robustly assessed by estimates without signs of a reversal trend.
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9 It should be especially noted that the group of countries known in the climate
10 change political arena as the Umbrella Group, currently led (in order of relevance)
11 by the US, Australia, Japan and Norway, is associated with a monotonic path
12 resembling that of the full sample⁶. This is plausible given the large weight of such
13 countries in global emissions, and contradicts the evidence we find for “pro-Kyoto”
14 regions, such as the EU, which are in favour of stringent, faster, and more
15 nationally based climate change policies. The Umbrella Group instead supports less
16 stringent (actions shifted to later in the future) and less costly policies (through the
17 abatement of emissions in developing countries). The latter is certainly relevant, but
18 out aim here is not to discuss which strategy is preferable, which is beyond the
19 scope of this paper and for which evidence, though mounting, is still ambiguous.
20 Nevertheless, we can say that our evidence confirms what has been emerging in the
21 political arena: the Umbrella Group claims that climate change should be addressed
22 by following an endogenous Kuznets path: economic growth, sooner or later, will
23 bring an inversion in the trend, with no or limited need for policy action. The
24 monotonic shape, which is an inverted U only in the complete range, confirms that
25 the underlying structure is coherent with the climate change actions supported. The
26 most stringent policy actions in the EU, which have led to a position favourable
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⁶ The inverted U is shown only for the range of values not constrained to the current observed GDP values. It is just a possibility for a future time.

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3 to the Kyoto protocol⁷, which has been ratified by the EU countries, but not by US,
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5 could in part explain the observed EKC path. We note only that this structure
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7 might claim for a relatively more important role, in terms of CO₂ abatement, of the
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9 Umbrella Group countries and the less developed areas. From an economic
10
11 efficiency perspective, the weight could be shifted to countries where the marginal
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13 cost is relatively lower: although other complementary evidence is needed to
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15 evaluate marginal costs, it is likely that these are lower when a Kuznets path is still
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17 not visible.

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19 To sum up, the full-sample analysis is thus a very approximate approach to
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21 investigating the presence of EKC. It hides regional and sub-sample differences,
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23 which is an indication of its questionable meaningfulness for economic and policy
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25 implications, although it provides some interesting insights.

Comment [CL6]: Is this what you
wanted to say?



26 27 28 29 30 **4.2.3 Cubic specifications**

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32 We conducted further analyses exploiting cubic specifications,⁸ which provides a
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34 slightly changed picture, which demonstrates their relevance here. The full sample
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36 presents an inverted N shape, but, as before, this analysis is less meaningful than
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38 specific geographical sub sample investigations.

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40 For the EU₁₅ and OECD countries, a mixed picture emerges. An N shape can be
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42 identified for the non-limited income range. However, we note that, within the
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44 incomes observed, the emerging shape is a typical Kuznets inverted U, with turning
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48 ⁷ Among others, see de Brauw (2006), Lindholt (2005) and Bohringer and Loschel (2003) for for
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50 policy-oriented empirical analyses on Kyoto Protocol issues recently published in this journal.

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52 ⁸ See fig.1 for fitted and real values of the cubic specifications.

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points at levels not very different from the above. This means that more industrialized countries have experienced an inversion in the emissions/GDP relationship; on average, the path of economic growth seems to provide a further boost to emissions, which is more than proportional, at least for regional aggregates. The N shape evidence is stronger for the EU than the OECD countries. In terms of the turning point, while the higher peak of N is well within the income range, the second, lower peak is higher than the observed incomes (our levels are above \$30,000 per capita at 1990 constant prices). In the near future then, emissions could be characterized by a positive elasticity with respect to GDP per capita. In any case, the G7 group actually presents a monotonous inverse of emissions, even without signs of EKC reversal. The monotonic shape for the Umbrella Group is confirmed at this stage of the analysis.

Comment [CL7]: Aggregate figures?
Ranges? Levels?

This evidence is plausible. Vollebergh and Kemfert (2005) underline that, on the one hand, technological change effects, complementarities between local and global emissions reduction efforts and policies recently implemented by some of the wealthier areas, may favour the re-shaping of the income- CO₂ relationship towards an EKC curve, or absolute delinking, while on the other hand, the long term nature of CO₂ abatement benefits and the global dimension of agreements still act as counter-balancing forces. EKC shapes with different (“high” and “low” as in an N-shaped curve) turning points over time, may be compatible with the dynamics of industrialized countries. Scale effects are mitigated and somewhat reversed by supply side and demand side effects as well as by emerging policies, but nevertheless along a non-linear path.

Finally, evidence for the non-OECD and poorest countries highlights signs of the three income terms: negative, positive and negative. This implies an “inverted N

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shape” dynamics, which would imply a potential EKC dynamics for less developed countries. In any case both non-OECD countries and the 40 poorest countries (consistently) present monotonic relationships within the income range, confirming the quadratic specifications outcomes. The only turning point observed for non-OECD countries is largely outside the income range.

Comment [CL9]: Or do you mean 40 (consistently) poorest countries

4.2.3 Summing up the evidence

We can see that in both the quadratic and the cubic specifications, and as suggested by various authors, the full sample analysis hides some more interesting and critical dynamics⁹. Both specifications lead to an EKC dynamic for the more developed countries while, as expected, monotonously-rising emissions with respect to GDP, are observed for the less developed countries.

Comment [CL9]: Do you mean monotonically

However, the cubic specifications provide some additional evidence. The more industrialized countries may be experiencing a new dynamic where the elasticity of emission with respect to GDP returns to a positive value, after a phase of decrease. The turning points at which both inversions occur are below \$20,000 per capita,

⁹ Even preliminary analysis from scatter plots clearly shows that heterogeneity concerning EKC trends is a key issue. We also argue that the scatter plots show that a high value added may derive from analyses based on country level data, possibly exploiting geographic/economic within-country heterogeneity. See, as rare examples, List and Gallet (1999), Managi (2006) for EKC frameworks, and Kim (2004) in the original Kuznets curves literature. The simple but useful scatter plot investigation highlights that, at least in panels with long time series, the cross country heterogeneity is an even more crucial issue. Dynamic trends could differ sharply from country to country, leading to the (here) often stressed necessity of using either heterogeneous estimators, or country specific time series/panel datasets.

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4 and above \$30,000. Stocking to observed income ranges, the EKC hypothesis is
5 valid for more industrialized countries.

Comment [CL10]: Do you mean the
more industrialized or more countries (a
greater number)

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8 Developing countries, on the other hand, and according to the cubic regressions,
9 experience a monotonic increase in CO₂, with weak signals favouring EKC shapes,
10 but with a turning point well outside the income range¹⁰. Overall, the cubic
11 specifications tend to support the evidence for EKC trends in the industrialized
12 countries¹¹.

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17 Aggregate evidence, in terms of average slope coefficients, is still against EKC
18 dynamics; further research could be carried out on specific countries, both
19 industrialized and industrializing. In any case, our evidence provides specific tests
20 on sub-samples of countries, showing the added value of these estimates compared
21 to those for the full sample¹².

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4.3 Forecast performances

¹⁰ EKC trends in the non-OECD countries have been, and will be more and more in the future, driven by fast growing and high energy consuming countries, such as India and China. Meunier (2004) exploits data for the 30 Chinese regions for 1990-1999, and for CO₂ finds some initial evidence in favour of an EKC. The peaks are quite sensitive to the specification used, ranging from Yuan 2,900 to Yuan 8,500 per capita in 1995.

¹¹ We decided to present both the quadratic and cubic specifications (although the robustness of the latter may make any comments on the former irrelevant) to show the consequential estimation procedures related to testing the usual EKC hypothesis against the relatively new N shape modified hypothesis.

¹² For a recent example of (mixed) EKC evidence on CO₂ for a sample of 84 countries and 40 years, see Kahuthu (2006).

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4 In order to test the relative performance of the quadratic and cubic specifications
5 more formally, we carried out some procedures to assess what, at least in terms of
6 forecast properties, is the preferred specification for our data. In this section we
7 use criteria of performance of the prediction in order to inform the choice between
8 quadratic and cubic specifications. We re-estimated the model using observations
9 from 1949 to 1996, reserving the last five years (1997-2001) for forecasts. The
10 choice of a time span of less than five years is consistent with the need to test
11 forecasting, and allows comparison of both specifications. In fact, it is intuitive that
12 longer spans may by default omit the cubic shapes obtained from fitting the data,
13 since N shapes are eventually characterized by final more recent trends towards an
14 EKC dynamics.

15
16 Table 2 enables a comparison of different specifications using the root mean square
17 errors (RMSE) criterion. As pointed out by Baltagi et al. (2004), the ability of an
18 estimator depends on both short-run and long-run forecast performance.
19 Consequently, the average RMSE is calculated across countries at different
20 forecasting horizons. We report the RMSE after one year, five years and the average
21 of 5 years.

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23 The estimated parameters (not reported here) are very similar to those obtained for
24 the entire time period (Table 1). Overall, we can conclude that the forecast
25 performance of the quadratic specifications is better than that of their cubic
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3 counterparts for the one year and five year forecast horizons. The only exception is
4 when the 5 year horizon is considered for the full sample of countries¹³.

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7 We can see that  we analyze the quadratic specification the one year forecast
8 performance is very good for all sub samples while the quality of the five year
9 counterparts depends on the sub-sample analyzed¹⁴.

Comment [CL11]: Or do you mean
we can say

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12 It should also be mentioned that overall the forecast performance of the
13 hierarchical Bayes estimator increases as the size of the sample analyzed increases.
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15 This may simply be due to the relative weight of each country, which decreases
16 when the simple size increases, and thus the presence of outlier countries should
17 have less effect for a large sample of countries.
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26 5. Conclusions

27 This paper provides evidence of EKC-like dynamics for CO₂ emissions. This
28 evidence confirms other recent results by exploiting a hierarchical Bayes estimator
29 consistent with long time series panel data. We provide evidence of an EKC
30 relationship between per capita emissions and income per capita, which, as
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38 ¹³ Although these less than clear cut results have many possible interpretations, we argue that they
39 may be evidence that the sub-sample analyses are more relevant. For these, the quadratic
40 specification is always preferred.
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44 ¹⁴ Even this outcome is open to interpretation; given that the literature does not indicate an
45 “optional” rule for defining a proper forecast length, this result may mean that the loss of 5 years in
46 the estimation process is relevant for achieving a good forecast. The 1 year forecast is the proper
47 framework of assessment in this case. Scatter plots (fig. 2 depicts plots for the EU) nevertheless
48 exclude the fact that the underlying reason for high values in the 5-year case may be due to a
49 preference for a linear specification rather than a quadratic or cubic specification.
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3 expected, is limited to the OECD, G7, and EU₁₅ groups. A monotonic relationship
4 between income and emissions characterizes the less developed countries. The
5 results of the cubic specifications point to the possible emergence of an N shape in
6 the CO₂ emission paths in industrialized countries, and signal potential EKC
7 dynamics for less developed countries. However, cubic specifications are not the
8 preferred specifications for forecasting, for which quadratic specifications are more
9 appropriate, and especially for informing policy makers. Within quadratic
10 specifications, we note the interesting Kyoto-relevant evidence regarding EU and
11 the so called Umbrella group: the former shows EKC dynamics while the latter a
12 clear monotonic shape. This may be food for thought to policy making and post
13 Kyoto negotiations.
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The existence of EKCs does not imply that sustainability is a necessary outcome of economic growth. From a policy perspective, it is important that EKC evidence should not be interpreted as that rapid growth to high levels of GDP per capita automatically drives an 'absolute' or 'relative' delinking between CO₂ emissions and income; if this were the case, then growth would be the best 'policy strategy' to reduce environmental impacts. In fact, GDP growth has a direct 'scale effect' on emissions and, if it is not sufficiently innovative leading to emission efficiency (per capita and/or per unit of GDP) the 'scale effect' of income growth on emissions may prevail. The possible emergence of N-shaped EKCs as well as other complex configurations of the growth-emissions relationships, and the country/region specificity of EKCs resulting from our analysis, are an indication of the non-deterministic nature of the relationship between growth and the environment. Even in the presence of sustained growth, policy must not take a passive attitude towards the control of emissions.

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4 The main added value of exercises aimed at refining the identification and measure
5 of EKC relationships by employing new techniques, such as the one in this paper, is
6 in enabling this complexity and differentiation to emerge. We argue that the
7 proposed method is a valuable tool for cross country EKC analyses. Provided the
8 problems posed by heterogeneity in examining and interpreting cross country
9 focused datasets, research alternatives are time series or panel analysis at country
10 level that exploit regional/provincial heterogeneity
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17 These exercises, however, cannot substitute for explicit analyses of the economic
18 and technological factors possibly leading to EKC-like dynamics, such as complex
19 endogenous dynamics of economic systems, energy/emission innovations, and the
20 effects of policies.
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Appendix. Data sources and definitions

Data on emissions are from the database on global, regional, and national fossil fuel CO₂ emissions prepared by Marland et al. (2005) for CDIAC - Carbon Dioxide Information Analysis Center, US Department of Energy (available at cdiac.esd.ornl.gov). The database includes data on emissions dating back to 1751 for some countries, and for the world, and for 1950-2002 for the majority of countries. The latter set of data is derived from energy statistics published by the United Nations in 2005 using Marland and Rotty's (1984) methods. In this paper, we used the subset of emission data matching with the available time series on GDP per capita on the basis of joint availability, series continuity, and country definitions. This resulted in a sample of 109 countries for the period 1959-2001.

Data on GDP per capita for all 109 countries are from the database on the historical statistics of the world economy based on Maddison (2002), and managed by the OECD (www.theworldeconomy.org). Data on GDP per capita for all countries are in 1990 International 'Geary-Khamis' dollars, as used in the International Comparison Program (see unstats.un.org/unsd/methods.htm for details).

For country groups/aggregations, we adopted the current official composition of the G7, EU15 and OECD. The non-OECD group includes all 109 countries excluding OECD countries. The group of 40 poorest countries includes the 40 countries in our sample with the lowest per capita GDP.

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For Peer Review

Table 1. Hierarchical Bayes Estimations (dependent variable: $\ln(\text{CO}_2)$)

| Specification | Quadratic specification | | | | | | | Cubic specification | | | | | | |
|---|------------------------------|--------------------|--------------------|--------------------|--------------------|---------------------|----------------------|---------------------|--------------------|------------------------|--|---|---------------------|--------------------------|
| | Full sample | G7 | EU15 | OECD | NON-OECD | 40Poorest countries | Umbrella | Full sample | G7 | EU15 | OECD | NON-OECD | 40Poorest countries | Umbrella |
| Constant term | -9.98*** (0.15) | -50.9*** (0.08) | -50.9*** (0.06) | -42.4*** (0.08) | 0.42*** (0.05) | 0.30*** (0.06) | -18.88*** (0.98) | 6.61*** (0.03) | -482*** (0.05) | -395*** (0.02) | -132*** (0.01) | 11.11*** (0.05) | -6.39*** (0.07) | 16.18*** (0.05) |
| $\ln(y)$ | 1.96*** (0.04) | 10.91*** (0.09) | 10.76*** (0.08) | 8.91*** (0.08) | -0.29*** (0.03) | -0.16*** (0.03) | 3.84*** (0.23) | -2.74*** (0.03) | 145*** (0.07) | 118.9*** (0.02) | 31.7*** (0.01) | -4.53*** (0.03) | 3.09*** (0.06) | -7.40*** (0.15) |
| $(\ln(y))^2$ | -0.08*** (0.004) | -0.56*** (0.02) | -0.56*** (0.01) | -0.45*** (0.01) | 0.04*** (0.004) | 0.02*** (0.005) | -0.176*** (0.012) | 0.35*** (0.007) | -14.6*** (0.09) | -11.8*** (0.03) | -2.24*** (0.03) | 0.59*** (0.01) | -0.50*** (0.015) | 1.03*** (0.04) |
| $(\ln(y))^3$ | | | | | | | | -0.01*** (0.002) | 0.49*** (0.09) | 0.39*** (0.03) | 0.04* 0.024 | -0.02*** (0.002) | 0.03*** (0.005) | -0.04* (0.025) |
| Shape1 | Inverted U | Inverted U | Inverted U | Inverted U | U | U | Inverted U | Inverted N | monotonic | N | N | Inverted N | monotonic | Inverted N |
| Shape 2 | monotonic | Inverted U | Inverted U | Inverted U | monotonic | monotonic | monotonic | Inverted N | monotonic | Inverted U | Inverted U | monotonic | monotonic | Monotonic |
| Per capita GDP range | 201-43806 | 3553-28129 | 2794-23201 | 1105-28129 | 201-43806 | 201-2991 | 1843-28129 | 201-43806 | 3553-28129 | 2794-23201 | 1105-28129 | 201-43806 | 201-2991 | 1843-28129 |
| Turnings points | Out 1.045×10 ⁵ | 14688 | 16105 | 18607 | Out 62 | Out 71 | Out 53852 | 535; 32338 | | 17693; Out 32533 | 13179; Out 1. 23×10 ¹² | Out; Out 186 1.86×10 ⁶ | | Out, Out 254 30760 |
| χ^2 test of coefficients constancy | 1.3e+05*** | 14023*** | 18173*** | 50713*** | 59213*** | 16989*** | 11283*** | 1.7e+04*** | 1965*** | 10862*** | 14143*** | 21422*** | 14632*** | 860*** |

Notes.

Standard errors in brackets.

*: significant at 10% level; **: significant at 5% level; ***: significant at 1% level.

Shape 1 indicates the shape of the relationship considered in the domain interval $-\infty < y < \infty$.

Shape 2 indicates the shape of the relationship considered in the domain interval defined in the range of the observed values.

Per capita GDP range and turnings points are expressed in 1990 dollars.

Out indicates that the turning points are located outside the domain interval of per capita GDP.

Table 2. Comparison of forecast performances

| Specification | 1 st year RMSE | 5 th year RMSE | 5-year average RMSE |
|----------------------|----------------|---------------------------|---------------------|
| QUADRATIC | | | |
| Full sample | 0.077 | 10486 | 2318 |
| G7 | 0.040 | 242676 | 51769 |
| EU15 | 0.034 | 1652550 | 340523 |
| OECD | 0.053 | 1021910 | 210967 |
| Non OECD | 0.092 | 1.77 | 1.43 |
| 40 poorest countries | 0.050 | 0.75 | 0.59 |
| Umbrella Group | 0.083 | 46834 | 10104 |
| CUBIC | | | |
| Full sample | 8.88 | 92.42 | 31.91 |
| G7 | 416 | 5.87E10 | 1.18E10 |
| EU15 | 311 | 4.13E10 | 8.33E9 |
| OECD | 162 | 1.30E9 | 2.64E8 |
| Non OECD | 14.92 | 2706 | 681 |
| 40 poorest countries | 9.07 | 1052 | 320 |
| Umbrella Group | 36 | 34324 | 8093 |

Low values indicate good forecast performance. We refer to Baltagi et al (2004).

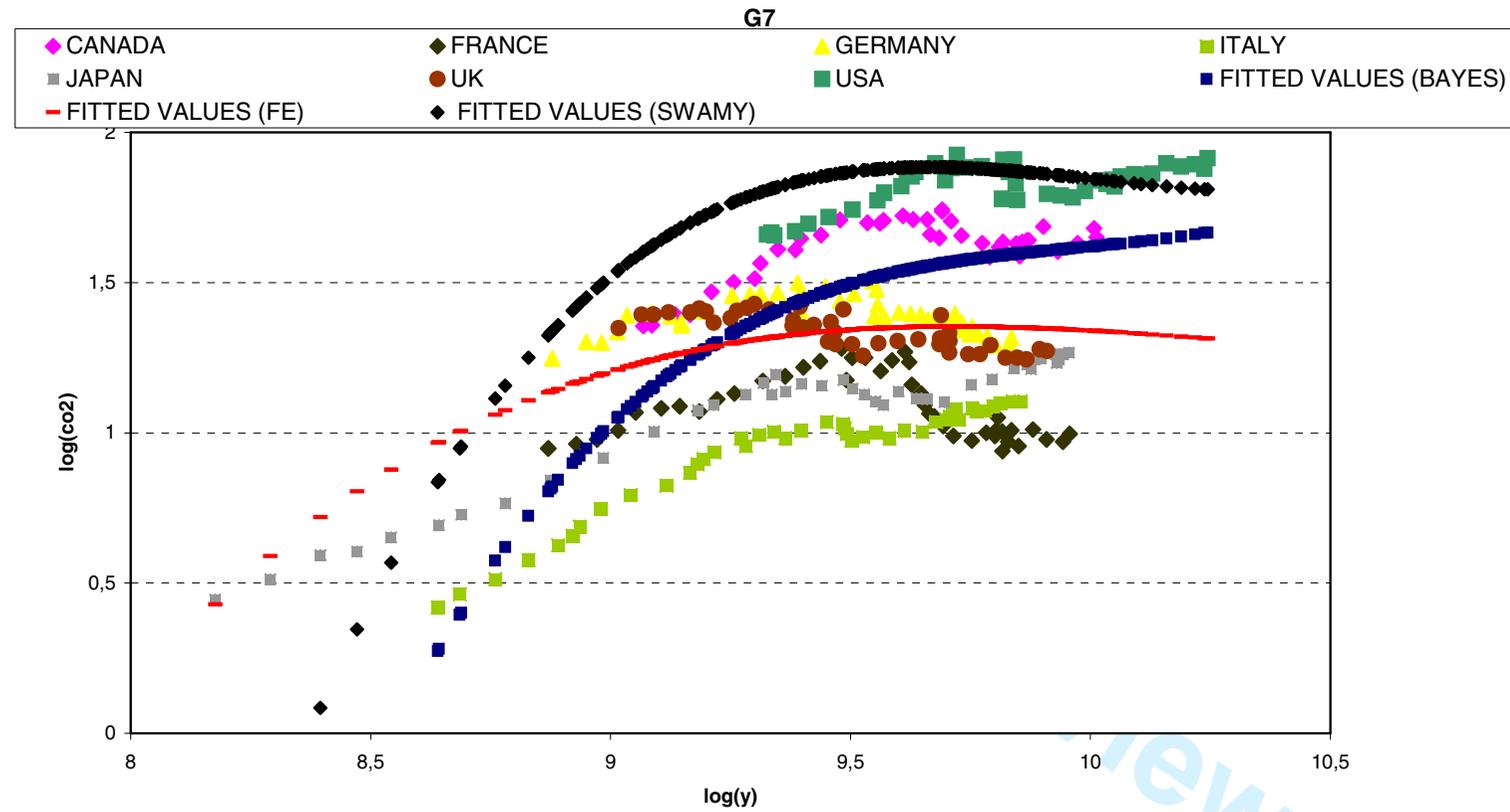


Figure 1. Real and fitted values – Cubic ECK specification

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Fig. 2 Scatter plots for EU₁₅

(attached as separate wmf file)

For Peer Review