

March 2006 ■ RFF DP 06-13

Energy and Carbon Dynamics at Advanced Stages of Development

*An Analysis of the U.S. States,
1960–1999*

Joseph E. Aldy

1616 P St. NW
Washington, DC 20036
202-328-5000 www.rff.org

Energy and Carbon Dynamics at Advanced Stages of Development: An Analysis of the U.S. States, 1960–1999

Joseph E. Aldy

Abstract

This paper explores the relationships among economic development, energy consumption, and carbon dioxide (CO₂) emissions by focusing on a set of advanced economies, the U.S. states. Energy consumption and emissions grew 50–60 percent on average over the 1960–1999 period. The states' per capita energy consumption and emissions have grown on average 2 percent annually as income and population growth have outpaced improvements in energy intensity of output and carbon intensity of energy. The energy consumption income elasticity is positive but decreasing in income, although energy production takes an inverted-U shape, reflecting the electricity imports among high income states. The standard CO₂ measure, corresponding to energy production, is characterized by an inverted-U environmental Kuznets curve. Adjusting emissions for interstate electricity trade yields an emissions–income relationship that peaks and plateaus. The carbon intensity of energy declines in income for total energy consumption and the industrial, residential, and commercial sectors.

Key Words: Engel curve, environmental Kuznets curve, cubic spline, Kaya identity

JEL Classification Numbers: Q43, Q54, Q56

© 2006 Resources for the Future. All rights reserved. No portion of this paper may be reproduced without permission of the authors.

Discussion papers are research materials circulated by their authors for purposes of information and discussion. They have not necessarily undergone formal peer review.

Contents

Introduction.....	1
Energy, Emissions, and Income Data.....	3
Energy.....	3
Carbon Dioxide.....	4
Income.....	5
Energy and Emissions Decompositions.....	5
Energy–Income and Emissions–Income Relationships	9
Conclusion	14
References.....	16
Tables and Figures.....	18

Energy and Carbon Dynamics at Advanced Stages of Development: An Analysis of the U.S. States, 1960–1999

Joseph E. Aldy*

Introduction

The relationship between economic development and energy consumption is important in the context of a number of pressing policy issues. The increasing demand for energy as economies develop can influence when the world may peak in its oil production. Growing energy consumption poses a variety of public health and environmental risks that can spur government and market actions to modify the fuel mix and adopt new emissions control technologies. As economic growth results in greater fossil fuel combustion, the increase in carbon dioxide (CO₂) emissions can exacerbate the risks of global climate change.

This paper explores the relationship between economic development and energy consumption and CO₂ emissions by focusing on a set of advanced economies, the U.S. states. Understanding energy-emissions-income dynamics at an advanced stage of development may provide insights for national-level dynamics as more countries develop and attain higher incomes. An assessment of state-level energy consumption and CO₂ emissions is of interest in its own right as a number of states have initiated action on energy and CO₂ regulatory policies. This analysis illustrates the broad determinants of states' CO₂ emissions and provides some sense of the feasibility of state efforts to limit emissions. Finally, an assessment of the U.S. states can complement analyses of U.S. national-level energy consumption and CO₂ emissions.

This analysis builds on papers that have explored questions of energy-income and emissions-income relationships. Several papers have expressed per capita energy use as a quadratic function of per capita income (and other covariates). Galli (1998) examines the energy-income relationship for 10 Asian economies over the period of 1973–1990 and finds that energy consumption per capita first increases and then decreases with per capita incomes. For a set of 28 countries, Medlock and Soligo (2001) estimate a concave energy-income relationship and find that, among major sectors, per capita industrial energy use declines first, followed by the residential and commercial buildings sector, and finally by the transportation sector.

* Aldy is a Fellow at Resources for the Future. Address correspondence to Joe Aldy, Resources for the Future, 1616 P Street NW, Washington, DC 20036, or aldy@rff.org.

Accounting for the effects of manufacturing and trade on energy use, Suri and Chapman (1998) find that per capita energy follows an inverted-U shape, although the peak is beyond the maximum income in their sample of 33 countries. Judson et al. (1999) employ piecewise linear spline income functions to estimate more flexible energy–income relationships at both the economy and sector level for 123 countries. They find that per capita energy consumption increases with income, but at a declining rate, and that the transportation sector’s share of energy consumption increases with income while the household’s share declines with income.

Darmstadter (2001) used the Kaya Identity to decompose U.S. CO₂ emissions by population growth, per capita income growth, the energy intensity of output, and the CO₂ intensity of energy. He finds that the U.S. energy intensity of output and the CO₂ intensity of energy both declined over time, but at rates insufficient to offset income and population growth. Holtz-Eakin and Selden (1995) provide the first environmental Kuznets curve (EKC) analysis of CO₂ per capita using a large international data set and find an inverted-U emissions–income relationship. Schmalensee et al. (1998) employed similar methods as Judson et al. (1999) and find that per capita emissions peak at about \$10,000 (1985\$). Aldy (2005) estimated inverted-U EKCs for state-level per capita CO₂. After adjusting emissions for interstate electricity trade, he finds that the peak in the inverted-U occurs at higher incomes and per capita emissions decline modestly after the peak than with the standard pre-trade CO₂ measure.

Rothman (1998) focuses on the effect of trade in the distinction between the location of consumption and the location of production and noted the shortcomings in most EKCs in this respect. Suri and Chapman (1998) find that trade can influence the shape of their estimated energy–income function because industrialized countries have increased their imports of energy-intensive goods. Aldy (2005, 2006) shows that interstate electricity trade can affect estimated emissions–income relationships and the convergence in per capita emissions.

To complement the existing literature, this empirical analysis focuses on state-level energy consumption and CO₂ emissions over the period of 1960–1999. Investigating the energy–emissions–income dynamics of a set of advanced economies follows in the spirit of Barro and Sala-i-Martin (1992), who studied the economic convergence dynamics of the U.S. states in order to better understand convergence and growth in the broader world. This paper makes several contributions to the literatures on energy– and emissions–income elasticities and energy policy debates. First, it provides the initial characterization of state-level energy dynamics through Kaya Identity analysis and regression analysis based on flexible piecewise linear and cubic spline income functions. I find that energy consumption has grown about 2 percent annually over the period of 1960–1999, and that the income elasticity of energy consumption is

always positive but decreasing with income. Second, it employs a novel data set of state-level CO₂ emissions constructed by the author to explore the emissions–income relationship. CO₂ emissions have also grown about 2 percent per year as population and income growth have outpaced the declining energy intensity of output and the modest change in the carbon intensity of energy. I find an inverted-U emissions–income relationship for the standard CO₂ per capita measure. Third, it illustrates the effects of interstate electricity trade on energy–income and emissions–income relationships. Accounting for interstate electricity trade shows that per capita energy production follows an inverted-U shape with respect to income, similar to the form for the standard measure of CO₂. Adjusting emissions measures for electricity trade produces a peak and plateau emissions–income relationship instead of the inverted-U. Finally, it illustrates how the energy–income relationships vary across major end-use sectors. I find transportation and commercial sectors growing with income, slow growth in the residential sector, and an inverted-U pattern in the industrial sector.

The next section describes the data used in the analysis, including a detailed discussion of the construction of the state-level CO₂ data. The second section illustrates the trends in energy consumption and CO₂ per capita and the energy and emissions intensity of economic output. The third section decomposes the growth in energy consumption and emissions through the Kaya Identity for a variety of sectors of the economy. The fourth section presents energy–income and emissions–income elasticities estimated through flexible piecewise linear and cubic spline regressions, with a focus of the effects of electricity trade on these estimated relationships. The final section concludes with policy implications and ideas for future research.

Energy, Emissions, and Income Data

Energy

The Energy Information Administration (EIA) has compiled state-level energy consumption by fuel type and sector for 1960–1999 as a part of the State Energy Data System (EIA 2001b). The State Energy Data System provides end-use energy consumption data for the transportation, industrial, residential buildings, and commercial buildings sectors. These estimates include consumption of petroleum products, natural gas, coal, and renewable fuels. The sectoral estimates also account for the consumption of electricity generated from fuel oil, coal, natural gas, nuclear power, and renewables. Interstate electricity data are also available in this data set. All data used in this analysis are presented in British Thermal Units (BTUs).

Carbon Dioxide

I have constructed state-level CO₂ emissions estimates based on the fossil fuel combustion data for 1960–1999 from EIA (2001b).¹ I converted energy consumption to CO₂ emissions using national sector- and fuel-specific emissions factors provided by EIA (2001a, Appendix B). A total of 51 fuel-sector measures allowed for precise matches of fuel-sector emissions factors to sector-specific fuel consumption. Refer to Lutter (2000), Marland et al. (2003), and Blasing et al. (2004) for similar applications of this approach.

I undertook two checks to assess the plausibility of constructing state-level CO₂ emissions in this manner. First, I constructed national estimates from the state-level CO₂ emissions values and compared these with the Marland et al. (2003) and EIA (2001a) estimates for national emissions. Over the period of 1960–1999, my constructed annual national values differ on average 1.9 percent from the Marland et al. estimates (6.0 percent maximum annual differential) and 2.0 percent from the EIA estimates (4.8 percent maximum annual differential). To provide context for these comparisons, a comparison of the EIA and Marland et al. data sets arrives at similar differences: an average difference of 1.7 percent with a 4.5 percent maximum annual difference.

Second, I compared my data set with a state-level CO₂ emissions data set published after I began this research project. The Blasing et al. (2004) data set is constructed from the same source file as mine (EIA 2001b), so the comparison can assess only differences in the methods used in constructing CO₂ from fossil fuel consumption. Blasing et al. note that their aggregate national values differ from other national values (e.g., Marland et al. 2003) “by around 2 percent.” I have replicated the cubic spline regression presented in Figure 4 and find that the estimated EKC’s are very similar for both the Blasing et al. and my data sets.²

My constructed carbon dioxide data set represents emissions associated with producing all goods and services in a given state, so we can also denote them *production* CO₂ emissions. The standard measure of CO₂ emissions, this is comparable to the national measures used to develop greenhouse gas commitments under the Kyoto Protocol. In the presence of interstate trade, the emissions intensity of a state’s production may differ from the intensity of this state’s

¹ All statistical analyses presented in this paper exclude Alaska, Hawaii, and Washington, DC.

² Additional details comparing the two data sets are available from the author upon request.

consumption. Some states may specialize in carbon-intensive production and export a substantial share of this output, while others may specialize in carbon-lean production for export.

To illustrate the potential role of trade in measuring carbon dioxide, a second emissions data set was constructed to account for interstate electricity trade. To construct this post-electricity trade CO₂ data set, I started with the production CO₂ data set. Then, I calculated the annual average carbon-intensity of each state's electricity sector. For a state that is a net exporter of electricity in a given year, the carbon emissions associated with the exported electricity (reflecting the state's average electricity carbon intensity) are deducted from that state's total emissions for that year. For a net importer, that state's emissions are augmented based on the average carbon intensity of electricity imports.³ Since this modified measure reflects post-trade emissions and attempts to approximate for *consumption* emissions, as opposed to the production or standard measure of emissions, I refer to it as consumption CO₂ throughout this analysis.

A second reason for referring to this measure as consumption CO₂ is that it corresponds to end-use energy consumption measures. For example, a state's industrial sector energy consumption includes that sector's electricity consumption. If this state is an electricity importer, then some of the industrial sector energy consumption is associated with CO₂ emissions in electricity-exporting states. Sectoral CO₂ values presented below are this consumption CO₂ measure to ensure comparability with the sectoral energy consumption data.

Income

I use the Bureau of Economic Analysis (BEA) (2000) state personal income series as my income measure.⁴ This series has been used in EKC, emissions convergence, and economic growth papers (e.g., Aldy 2005, 2006; and Barro and Sala-i-Martin 1992). BEA also provides the annual population data used to construct per capita estimates.

Energy and Emissions Decompositions

To provide an initial illustration of state-level energy consumption and CO₂ emissions, I've estimated annual mean per capita measures and their associated 95 percent confidence

³ This average intensity of imports is a national average; it reflects the average intensity of electricity generation for all states that export electricity in that year. Although the carbon-intensity of the marginal power source for electricity would be preferable, it is difficult to determine what constitutes the marginal source in each state.

⁴ These were converted to constant-year (1999) dollars based on the national CPI-Urban deflator.

intervals. Figure 1 shows how energy consumption per capita has increased on average 50 percent since 1960 among the states. In 1999, the average state-level per capita energy consumption was 379 million BTUs. The confidence interval is fairly tight, with the 1999 95-percent-interval ranging between 1.33 and 1.61 times the 1960 per capita level. Because of a number of short-term declines, 1999 energy consumption was only slightly higher than in 1973. These short-term declines likely reflect the effects of high energy prices and slow or negative economic growth.

Figure 2 depicts a similar trend in production (standard) CO₂ emissions for the states. Per capita emissions grew faster than per capita energy consumption, although emissions declined in many of the same years as energy use. By 1999, per capita CO₂—at 6.6 tons of carbon—was on average 1.64 times greater than it was in 1960. The confidence interval is much wider by the 1990s for CO₂ per capita than for energy consumption per capita, reflecting how some states have differed in their use of various fossil fuels and the effects of interstate electricity trade.

To assess the major determinants of energy use and CO₂ emissions, the Kaya Identity can be used to decompose emissions (or energy use) into the effects of four drivers: population, per capita income, the energy intensity of output, and the carbon intensity of energy. This approach can illustrate whether changes in CO₂ emissions reflects decarbonization of energy (declining carbon-energy ratio) or improvements in energy efficiency or simply changes in economic growth or population growth. The Kaya Identity for CO₂ emissions is given by

$$CO_2 = Population * \left(\frac{Income}{Population} \right) * \left(\frac{Energy}{Income} \right) * \left(\frac{CO_2}{Energy} \right) \quad (1)$$

and a comparable equation for energy consumption is given by

$$Energy = Population * \left(\frac{Income}{Population} \right) * \left(\frac{Energy}{Income} \right). \quad (2)$$

To illustrate the trends in emissions and energy use, I have modified these two equations to present average growth rates (and associated standard deviations) for the states over 1960–1999 in Tables 1 and 2. The growth rates of the drivers are additive with respect to the growth rates for emissions and energy. Previous analyses of this type used standard measures of energy consumption and CO₂ emissions. Since the standard CO₂ measure corresponds to the production of electricity (pre-trade) while the energy consumption data correspond to the consumption of

electricity (post-trade), this may yield a biased characterization of decarbonization of energy. All analyses presented in Tables 1 and 2 are based on the consumption CO₂ measure, with discussion of how the choice of emissions measure influences the results.

In Table 1, Panel A, the average CO₂ growth rate of 2 percent is slightly less than the energy consumption growth rate of 2.1 percent. The growth in income per capita is 2.1 percent. This reflects the small change in the CO₂ intensity of energy (last column). The population growth rate of 1.1 percent is roughly offset by the 1.2 percent annual decline in the energy intensity of output. Some of the decline in energy intensity of output also reflects a transition from more energy-intensive economic activity, such as in manufacturing, to less energy-intensive activity, such as in services. The average manufacturing share of state income declined by nearly half from 20.1 percent to 11.5 percent over the period of 1960–1999. In contrast, the average services share of state income increased from 28.7 percent to 35.6 percent over this period.⁵ The rest of Panel A illustrates the effects of these major drivers of energy consumption and emissions for a sample of the 10 states with the lowest CO₂ growth rates (slow growth) and a sample of the ten states with the highest emissions growth rates (fast growth) over the period of 1960–1999. The slow growth states had a CO₂ growth rate (0.75 percent) four times slower than the rate for the fast growth states (3.2 percent). This substantial difference primarily reflects the faster population growth rates (0.54 percent versus 1.8 percent) and the decarbonization of energy in the slow growth states (–0.43 percent) in contrast with the carbonization of energy in the fast growth states (0.35 percent). Per capita income growth rates are virtually the same among the fast and slow growth states, and the slow growth states have more rapid declines in energy intensity. Failing to account for electricity trade would yield a faster rate of decarbonization of the slow growth states (–0.81 percent) and a faster rate of carbonization for the fast growth states (0.93 percent).

These growth rates mask considerable variation over the sample period. Panel B of Table 1 shows the Kaya Identity annual growth rates for the pre-oil shock period (1960–1973), the period of high oil prices (1973–1986), and the post-oil shock period (1986–1999). The emissions and energy consumption growth rates before 1974 were faster than the negligible growth during the oil shock period or the modest growth in the post-oil shock period. The lower CO₂ and

⁵ The services estimate reflects a broad categorization of services to include income in BEA-identified sectors of services, retail, wholesale, and financial activities. The manufacturing estimate reflects only the BEA-identified sector of manufacturing.

energy use growth rates during the second period reflected a substantial decline in economic growth (income per capita grew some 2.4 percentage points slower) and a much steeper decline in the energy intensity of output. The oil shocks clearly sent signals to reduce energy consumption and reallocate capital to less energy-intensive sectors, and the productivity slowdown starting in 1973 translated into slower income growth. The emissions and energy growth rates of 1.7 percent and 1.8 percent in the 1986–1999 period reflect primarily the faster rate of income growth and slower rate of decline in energy efficiency. Decarbonization of energy does not appear to be a major factor in any period—the rate of decline never fell below –0.3 percent.

To complement the total CO₂ emissions and energy consumption analyses, I present growth rates for the transportation, industry, residential, and commercial sectors in Table 2. These four panels present similar comparisons of the full sample, the 10 slow growth states in total emissions and the 10 fast growth states in total emissions. The income and population values used in these tables are the same as in Table 1, Panel A, but the energy and CO₂ emissions data are sector-specific. The transportation sector results in Panel A show that transport emissions (1.9 percent) have grown slightly slower and energy used in transport (2.3 percent) has grown slightly faster than the economy as a whole for the full sample. There are minor differences between the energy intensity and the carbon intensity measures for the slowest and fastest growth states. Virtually the entire difference in emissions between these two sets of states lies in the slower population growth in the lowest 10 states. The similarities in the energy-intensity and carbon-intensity measures reflect the national-level approach to fuel economy and the limited opportunities for adjusting the fuel mix that powers the transport sector. The very modest decline in carbon intensity illustrates the increasing use of ethanol (from zero before 1980 to about 0.5 percent of all transportation fuel in 1999), but the transportation energy and emissions measures do not account for the energy and CO₂ emissions associated with making ethanol.

The industrial sector experienced slower emissions and energy growth than any other major sector of the economy (Panel B). For the full sample, emissions grew 1.5 percent per year and energy consumption grew at 1.6 percent per year. The significant decline in the energy intensity of the industrial sector (–1.6 percent) drove this result. The decline in energy intensity in the low emissions rate states may reflect very slow growth in the industrial sector more so

than energy efficiency improvements. Using BEA (2000) data on income by economic sector shows that manufacturing industries grew about 0.3 percent per year for the lowest growth states as the fast growth states experienced annual manufacturing income growth of 3.0 percent.⁶

Panel C presents the growth rates for the residential sector. Although residential energy consumption per capita increased 2 percent annually for the full sample over 1960–1999, CO₂ emissions grew faster at 2.5 percent per year. The markedly slower energy and CO₂ growth rates in the slow growth states reflect the slower population growth and, to a lesser effect, declining energy intensity. Growing electricity use increased the carbon content of residential energy use and more than offset the shift away from heating oil and towards natural gas. Residential consumption of natural gas—with about 25 percent less carbon per BTU than petroleum products—grew 1.6 percent per year as heating oil consumption declined 2.3 percent annually over the period of 1960–1999.

Commercial energy consumption grew faster than any other sector at 3.2 percent for the full sample, 2.2 percent for the slow growth states, and 3.9 percent for the fast growth states (Panel D). Likewise, this sector experienced faster growth in CO₂ emissions (3.1 percent) than any other sector. The growth in electricity offset the decarbonization associated with the growth in natural gas consumption (3.1 percent per year) and the declines in petroleum product consumption (–0.6 percent per year) and coal consumption (–5.8 percent per year).

Energy–Income and Emissions–Income Relationships

To further illustrate the energy–income and emissions–income relationships, I have conducted regression analysis with flexible income specifications. In the context of energy consumption, these are reduced form Engel curves and in the context of CO₂ emissions, these are EKC. The general regression specification takes the following forms:

$$\ln(c_{it}) = F[\ln y_{it}; \beta] + \alpha_i + \tau_t + \varepsilon_{it} \quad (3)$$

$$\ln(e_{it}) = F[\ln y_{it}; \beta] + \alpha_i + \tau_t + \varepsilon_{it} \quad (4)$$

⁶ The definition of sectors differs between the EIA and the BEA, so it is not possible to make more exact comparisons between the EIA's industry sector and the BEA economic sectors.

where c_{it} is per capita CO₂ in state i in year t , e_{it} is per capita energy consumption, y_{it} is per capita income, β is a vector of parameters to be estimated, α_i and τ_t are state and year fixed effects, and ε_{it} is the error term.

I characterize the income function in two ways: (1) a piecewise linear spline function, like Schmalensee et al. (1998) and Judson et al. (1999); and (2) a cubic spline function. Regression with a linear spline function yields income elasticity estimates specific to each of a series of income ranges (or spline segments), delineated by analyst-chosen knots or points in the income data. The cubic spline ensures that the estimated function is smooth (twice everywhere differentiable) by fitting cubic functions of income in-between similar analyst-chosen knots in the data. For example, one could choose nine knots in the data, one at each decile in the income distribution. For the piecewise linear spline specification, this would yield 10 income elasticities for the 10 deciles in the distribution. Instead of fitting a linear relationship, the cubic spline functions would fit cubic polynomials for each decile but constrained to be smooth at the knots. I experimented with a variety of specifications, including one to as many as 15 knots for both the piecewise linear spline and cubic spline functions. Specification tests were performed to determine the smallest number of knots or segments that could be employed without significantly losing explanatory power in the specification.

The cubic spline specifications show substantial differences between the consumption and production measures for both energy and emissions. The piecewise linear spline approach produces income elasticity estimates that facilitate comparisons. To assess whether these differences are statistically meaningful, I specify a 2-equation system of the production and consumption measures of energy (and emissions in an analogous 2-equation system) and test for equivalence of income elasticities for the income ranges under consideration

$$H_0^j : \beta_j^{\text{consumption}} = \beta_j^{\text{production}} \text{ for } j = 1, \dots, J \text{ number of income ranges (splines)} \quad (5)$$

where the β 's are the coefficient estimates for the natural logarithm of income for the J spline segments. Rejecting the null hypothesis for a given pair of coefficient estimates indicates that the consumption of energy responds to an increase in income in a statistically different manner than the production of energy for that income range.

Incorporating state and year effects is important for estimating the energy–income and emissions–income relationships. With the state effects, I can control for the constant or persistent differences among states—such as different energy demands among cold states and warm states—that may be correlated with income. For example, four of the five highest income states in 1999 (Connecticut, Massachusetts, New Jersey, and New York) had higher than average heating degree days. I can control for the effects of technological change and energy price shocks, to the extent that these are common across states, with the year fixed effects.

Figures 3–6 present the results from various cubic spline specifications, and Table 3 presents the results from the piecewise linear spline specifications. The estimated energy consumption–income relationship is presented in Figure 3. Energy consumption increases with income for the range of incomes under consideration in this analysis (about \$7,000–\$39,000 per capita). This differs from the Judson et al. (1999) finding that energy consumption per capita declines at the highest income ranges in their country-level sample and the inverted-U relationships found with the quadratic specifications in Medlock and Soligo (2001) and Galli (1998). Judson et al. note, however, that “the evidence for a negative elasticity at high income levels is, in this sample, less than compelling” (p. 45). The declining income elasticities with income evident in Table 3, column 1 are consistent with the Judson et al. results.

As noted above, interstate electricity trade has increased over the sample period. Estimates of states’ energy production differ from those for energy consumption by removing electricity imports and adding electricity exports to the consumption measure. The energy production measure shows a markedly different shape—the per capita energy production peaks at about \$21,500 per capita. The subsequent decline in energy production per capita falls until the highest income observation has a state per capita energy production commensurate with a state at slightly more than \$12,000 per capita income. As states progress to higher income levels, they are relying more and more on other states to generate the electricity they consume.

The first two columns in Table 3 illustrate similar results for these two energy measures for the piecewise linear spline specifications.⁷ The income elasticities for energy consumption

⁷ Table 3 presents the results for an 8-segment piecewise linear spline. Specification tests for energy consumption could not reject an 8-segment spline but did reject simpler specifications. To ensure consistency in the comparisons, both 2-system equations were specified as 8-segment spline functions. The explanatory power does not vary substantially across spline specifications. For 8 to 15-segment splines, the R^2 s range between 0.9431 and 0.9436 (energy consumption), 0.9277 and 0.9281 (energy production), 0.9341 and 0.9346 (consumption CO_2) and 0.9259 and 0.9264 (production CO_2).

are positive for all eight income ranges, and seven of the eight are statistically different from zero at the 1 percent or 5 percent level. The income elasticities do decline with income over some of the sample range but rebound in the highest income group ($> \$31,655$). In contrast, the energy production function follows the inverted-U shape depicted in Figure 3, with a decline in energy production starting with the \$20,537–\$25,497 income range. Tests comparing the income elasticities reveal substantial differences between energy consumption and production starting with incomes of about \$16,500. The rows below each pair of income elasticities present the F-statistics for the Wald tests of the null hypothesis of equivalence of elasticity estimates. With F-statistics ranging between 14.92 and 84.21, it is clear that the energy–income relationship differs significantly between consumption and production for the higher incomes in the sample.

The distinction between the location of electricity production and electricity consumption has no real impact on standard analyses of the energy consumption–income relationship because these typically employ a measure of end-use consumption. In contrast, standard EKC analyses of CO₂ per capita use emissions measures based on the geographic location of the fossil fuel combustion. If a lump of coal is burned in a power plant in Kentucky, but this electricity is sent to Ohio, then the carbon dioxide emissions would be assigned to Kentucky even though the typical measure of end-use energy consumption would assign the electricity to Ohio. Accounting for interstate electricity trade does have a substantial impact in estimating the states’ emissions–income relationship. Figure 4 shows that failing to account for electricity trade results in an inverted-U shaped emissions–income relationship—a standard EKC. Adjusting for interstate electricity trade and assigning emissions to where the electricity is consumed results in a very different shape—a peak, a modest decline, and a plateau in per capita emissions for the consumption CO₂ measure.

The last two columns of Table 3 present the results from the emissions–income piecewise linear spline specifications. Only one income range segment has a negative and statistically significant income elasticity for consumption CO₂, and the highest income range has a small elasticity that cannot be discerned from zero. This is roughly consistent with the peak, modest decline, and plateau evident in Figure 4. In contrast, income elasticities for the highest three income ranges are negative and statistically significant for production CO₂. With Wald test F-statistics ranging from 14.18–85.10, it is clear that these two emissions–income relationships are statistically different for the four highest income ranges.

The inverted-U EKC for production CO₂ is consistent with the Schmalensee et al. (1998) results. They estimate a peak in per capita emissions at about \$14,000, and I find a peak of \$16,000.⁸ The consumption CO₂ approach does not have an analog at the national level in the literature. These results suggest caution for long-term forecasting, such as in Schmalensee et al. (1998) and Holtz-Eakin and Selden (1995). If trade, whether in electricity or carbon-intensive goods, affects the estimation of national-level environmental Kuznets curves, then using production-based measures instead of consumption-based measures would yield downward biased estimates of long-term emissions as more countries develop.

Figure 5 presents the energy–income relationships for the industry, transportation, residential, and commercial sectors. Industrial energy consumption follows an inverted-U shape, likely reflecting the transition away from manufacturing as economies attain high levels of development. The transportation sector has a fairly steady increase in per capita energy use, reflecting the fairly steady increase in vehicle miles traveled over this period and the fact that there are fewer opportunities to substitute away from transportation uses at high incomes. A concave and flattening out energy–income relationship characterizes the residential sector. The commercial sector has the highest income elasticity among these four major end-use sectors.

These results suggest that transportation and commercial sectors' shares of energy consumption will increase with incomes as the industrial and, to a lesser extent, the residential sectors experience declining shares. This is consistent with the Judson et al. (1999) finding that transportation has an increasing share of energy consumption and industry follows a similar inverted-U shape. The relative shapes of these estimated sectoral functions are fairly similar to the sectoral energy–income profiles constructed in Figure 2 of Medlock and Soligo (2001).

Figure 6 illustrates how the carbon intensity of energy consumption varies with income. Figures 4 and 5 show energy consumption increasing at high incomes and an emissions profile peaking and plateauing at high incomes. These results suggest the decarbonization trends evident in Figure 6. For total consumption and the industrial, residential, and commercial sectors, the carbon content of energy steadily declines with income. Only transportation has experienced a negligible change in the carbon-energy ratio with respect to income.

These substantial declines (with average income elasticities on the order of -0.3 to -0.4) may initially appear to be inconsistent with the very small growth rates in the carbon-energy

⁸ I have converted the published income at the EKC peak from Schmalensee et al. to 1999 dollars.

ratio presented in Tables 1 and 2. The nature of decarbonization differs substantially between the wealthy and less wealthy states. The 10 highest income states in 1999 experienced an average rate of change in the carbon–energy ratio of -0.22 percent over the period of 1960–1999. In contrast, the 10 lowest income states in 1999 had a 0.11 percent annual growth rate in this ratio. Decarbonization does appear to occur as states achieve higher incomes. This is consistent with the Schmalensee et al. (1998) and Judson et al. (1999) claim that wealthy countries experience a decline in CO_2 per capita because of the transition from coal to natural gas for environmental policy reasons.

Conclusion

This paper provides an evaluation of the energy and emissions dynamics for the U.S. states—a set of economies at an advanced stage of development. The Kaya Identity assessment of the major drivers of energy and emissions shows that population and income growth exceed the reductions in the energy intensity of output and the carbon intensity of energy resulting in average growth rates of about 2 percent for energy and CO_2 . Differences in population growth and the change in the energy intensity of output explain most of the variation between slow emissions growth and fast emissions growth states. Differences in the carbon intensity of energy also distinguish slow growth and fast growth states in the residential and commercial sectors.

Regression analyses with piecewise linear spline and cubic spline specifications illustrate how energy and emissions change with respect to income. Energy consumption has a positive but declining income elasticity over the entire income range. CO_2 emissions associated with energy consumption (post-electricity trade measure of emissions) peak and plateau. The difference between these two estimated functions shows the decarbonization of energy evident in high-income states. This EKC for consumption CO_2 differs substantially from the standard inverted-U shape evident with the production CO_2 measure (and the related inverted-U for energy production). Tests of the estimated income elasticities in the piecewise linear spline specifications reveal that the consumption and production profiles are statistically different from each other for both energy and CO_2 starting at about \$16,500.

These results can help inform policymakers on a variety of issues. Understanding how per capita energy consumption changes as economies develop is useful for forecasting future energy demand and this can influence debates on issues such as resource extraction policies, alternative fuels R&D, and energy efficiency standards. The distinction between production and consumption measures of emissions and the role of interstate electricity trade is important in the development of emissions abatement programs. First, it suggests that economies cannot simply

grow their way out of pollution. Emissions per capita may appear to decline at high incomes (in the production measure EKC), but that reflects electricity imports more than decarbonization at high income levels. All economies cannot become net importers of electricity in the long term, so an emissions abatement program will be necessary to mitigate climate change risks. Second, the role of trade can influence the design of an emissions abatement policy. This has been noted as the Northeast states move forward with their Regional Greenhouse Gas Initiative and California's consideration of a load-based emissions cap to address the carbon content of imported electricity. Finally, the sector-specific analyses can highlight the opportunities to address fast-growing energy consumption activities.

These policy implications raise issues that merit further research. Additional analysis exploring the causes of the disconnect between electricity production and consumption can be insightful both for policymakers and for an understanding of energy institutions at advanced stages of development. Perhaps more importantly in the context of country-level emissions trends, future work could assess whether such a disconnect between production and consumption matters for tradable emissions-intensive goods. The relationship between CO₂ emissions and energy suggests that similar work on air pollutant emissions that are also by-products of fossil fuel combustion, such as nitrogen oxides and sulfur dioxide, also could benefit policymakers.

References

- Aldy, J.E. (2005). An Environmental Kuznets Curve Analysis of U.S. State-Level Carbon Dioxide Emissions. *Journal of Environment and Development* 14(1): 48–72.
- . (2006). Divergence in State-Level Per Capita Carbon Dioxide Emissions. RFF Discussion Paper 06–07. Washington, DC: Resources for the Future
- Barro, R.J. and X. Sala-i-Martin. (1992). Convergence. *Journal of Political Economy* 100(2): 223–251.
- Blasing, T.J., C.T. Broniak, and G. Marland. (2004). Estimates of Annual Fossil-Fuel CO₂ Emitted for Each State in the U.S.A. and the District of Columbia for Each Year from 1960 through 2001. In *Trends: A Compendium of Data on Global Change*. Oak Ridge, TN: Oak Ridge National Laboratory, Carbon Dioxide Information Analysis Center.
- Bureau of Economic Analysis. (2000). State Annual Tables 1929–1999. Washington, DC: U.S. Department of Commerce.
- Darmstadter, J. (2001). The Energy-CO₂ Connection: A Review of Trends and Challenges. In M. Toman (ed.), *Climate Change Economics and Policy: An RFF Anthology*. Washington, DC: RFF Press, 24-34.
- Energy Information Administration (EIA). (2001a). Emissions of Greenhouse Gases in the United States 2000. Washington, DC: U.S. Department of Energy.
- . (2001b). State Energy Data Report 1999: Consumption Estimates. Washington, DC: U.S. Department of Energy.
- Galli, R. (1998). “The Relationship Between Energy Intensity and Income Levels: Forecasting Long Term Energy Demand in Asian Emerging Countries.” *The Energy Journal* 19(4): 85–105.
- Judson, R.A., R. Schmalensee, and T.M. Stoker. (1999). “Economic Development and the Structure of the Demand for Commercial Energy.” *The Energy Journal* 20(2): 29–57.
- Lutter, R. (2000). “Developing Countries’ Greenhouse Emissions: Uncertainty and Implications for Participation in the Kyoto Protocol.” *The Energy Journal* 21(4): 93–120.
- Marland, G., T.A. Boden, and R.J. Andres. (2003). Global, Regional, and National CO₂ Emissions. In *Trends: A Compendium of Data on Global Change*. Oak Ridge, TN: Oak Ridge National Laboratory, Carbon Dioxide Information Analysis Center.

Medlock, K.B. and R. Soligo. (2001). "Economic Development and End-Use Energy Demand." *The Energy Journal* 22(2): 77–105.

Rothman, D.S. (1998). Environmental Kuznets Curves – Real Progress or Passing the Buck? A Case for Consumption-Based Approaches. *Ecological Economics* 25: 177–194.

Schmalensee, R., T.M. Stoker, and R.A. Judson. (1998). World Carbon Dioxide Emissions: 1950–2050. *Review of Economics and Statistics* 80(1): 15–27.

Suri, V. and D. Chapman. (1998). Economic Growth, Trade, and Energy: Implications for the Environmental Kuznets Curve. *Ecological Economics* 25: 195–208.

Tables and Figures

Table 1. Economy-Wide Energy Consumption and CO₂ Emissions Decompositions of Average Growth Rates, By Sample and Period

	<i>CO₂</i>	<i>Energy</i>	<i>Population</i>	$\frac{\textit{Income}}{\textit{Population}}$	$\frac{\textit{Energy}}{\textit{Income}}$	$\frac{\textit{CO}_2}{\textit{Energy}}$
A. By Sample						
Full Sample 1960-1999	0.020 (0.011)	0.021 (0.0088)	0.011 (0.0090)	0.021 (0.0031)	-0.012 (0.0045)	-0.00091 (0.0040)
Slow Growth States 1960-1999	0.0075 (0.0056)	0.012 (0.0050)	0.0054 (0.0034)	0.020 (0.0021)	-0.014 (0.0037)	-0.0043 (0.0031)
Fast Growth States 1960-1999	0.032 (0.011)	0.029 (0.011)	0.018 (0.014)	0.020 (0.0034)	-0.0097 (0.0060)	0.0035 (0.0036)
B. By Period						
Full Sample 1960-1973	0.042 (0.017)	0.041 (0.013)	0.013 (0.0098)	0.036 (0.0077)	-0.0076 (0.0089)	0.00078 (0.068)
Full Sample 1973-1986	0.00023 (0.015)	0.0032 (0.011)	0.011 (0.010)	0.012 (0.0065)	-0.020 (0.012)	-0.0029 (0.086)
Full Sample 1986-1999	0.017 (0.012)	0.018 (0.0088)	0.0093 (0.0089)	0.016 (0.0030)	-0.0077 (0.0063)	-0.00060 (0.0079)

Notes: States' average growth rates and their associated standard deviations in parentheses are presented. Estimated using author's consumption CO₂ emissions data constructed using EIA (2001a, 2001b), energy consumption data from EIA (2001a), and income and population data from BEA (2000). Slow growth states correspond to the 10 states with slowest CO₂ growth rates and fast growth rates correspond to the 10 states with fastest CO₂ growth rates for economy-wide fossil fuel CO₂ emissions over 1960–1999.

Table 2. Sectoral Energy Consumption and CO₂ Emissions Decompositions of Average Growth Rates, 1960–1999

	<i>CO₂</i>	<i>Energy</i>	<i>Population</i>	$\frac{\textit{Income}}{\textit{Population}}$	$\frac{\textit{Energy}}{\textit{Income}}$	$\frac{\textit{CO}_2}{\textit{Energy}}$
A. Transportation Sector						
Full Sample	0.019 (0.0083)	0.023 (0.0077)	0.011 (0.0090)	0.021 (0.0031)	-0.0090 (0.0057)	-0.0039 (0.0025)
Slow Growth States	0.012 (0.0067)	0.014 (0.0066)	0.0054 (0.0034)	0.020 (0.0021)	-0.011 (0.0066)	-0.0027 (0.00052)
Fast Growth States	0.024 (0.010)	0.029 (0.0081)	0.018 (0.014)	0.020 (0.0034)	-0.0098 (0.0074)	-0.0044 (0.0039)
B. Industrial Sector						
Full Sample	0.015 (0.015)	0.016 (0.012)	0.011 (0.0090)	0.021 (0.0031)	-0.016 (0.0090)	-0.0013 (0.0065)
Slow Growth States	-0.00050 (0.0089)	0.0067 (0.0096)	0.0054 (0.0034)	0.020 (0.0021)	-0.019 (0.0086)	-0.0072 (0.0042)
Fast Growth States	0.032 (0.014)	0.026 (0.014)	0.018 (0.014)	0.020 (0.0034)	-0.013 (0.0099)	-0.0057 (0.0053)

Notes: States' average growth rates and their associated standard deviations in parentheses are presented. Estimated using author's consumption CO₂ emissions data constructed using EIA (2001a, 2001b), energy consumption data from EIA (2001a), and income and population data from BEA (2000). Slow growth states correspond to the 10 states with slowest CO₂ growth rates and fast growth rates correspond to the 10 states with fastest CO₂ growth rates for economy-wide fossil fuel CO₂ emissions over 1960–1999.

Table 2. Sectoral Energy Consumption and CO₂ Emissions Decompositions of Average Growth Rates, 1960–1999, continued

	<i>CO₂</i>	<i>Energy</i>	<i>Population</i>	$\frac{\textit{Income}}{\textit{Population}}$	$\frac{\textit{Energy}}{\textit{Income}}$	$\frac{\textit{CO}_2}{\textit{Energy}}$
A. Residential Sector						
Full Sample	0.025 (0.015)	0.020 (0.011)	0.011 (0.0090)	0.021 (0.0031)	-0.012 (0.0048)	0.0054 (0.0077)
Slow Growth States	0.012 (0.0075)	0.010 (0.0046)	0.0054 (0.0034)	0.020 (0.0021)	-0.015 (0.0043)	0.0018 (0.0058)
Fast Growth States	0.042 (0.018)	0.030 (0.015)	0.018 (0.014)	0.020 (0.0034)	-0.0089 (0.0046)	0.012 (0.012)
B. Commercial Sector						
Full Sample	0.031 (0.014)	0.032 (0.010)	0.011 (0.0090)	0.021 (0.0031)	-0.0073 (0.0058)	-0.00091 (0.0085)
Slow Growth States	0.017 (0.0073)	0.022 (0.0061)	0.0054 (0.0034)	0.020 (0.0021)	-0.0038 (0.0056)	-0.0051 (0.0055)
Fast Growth States	0.045 (0.016)	0.039 (0.012)	0.018 (0.014)	0.020 (0.0034)	0.00023 (0.0084)	0.0063 (0.0077)

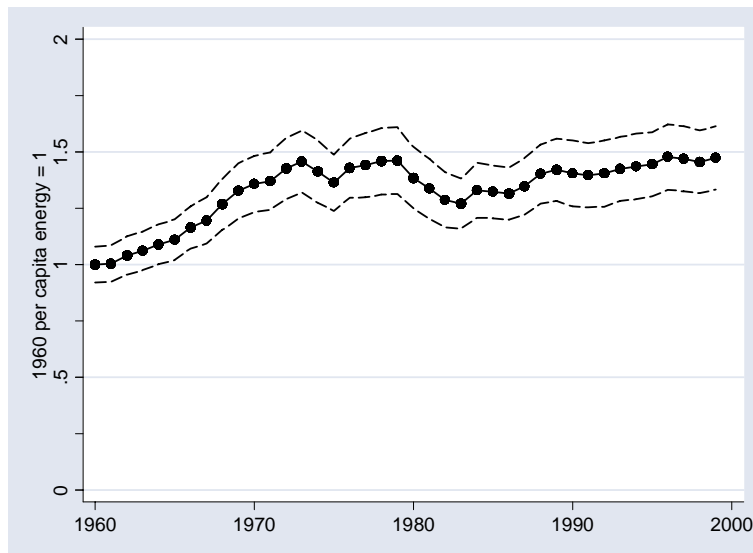
Notes: States' average growth rates and their associated standard deviations in parentheses are presented. Estimated using author's consumption CO₂ emissions data constructed using EIA (2001a, 2001b), energy consumption data from EIA (2001a), and income and population data from BEA (2000). Slow growth states correspond to the 10 states with slowest CO₂ growth rates and fast growth rates correspond to the 10 states with fastest CO₂ growth rates for economy-wide fossil fuel CO₂ emissions over 1960–1999.

Table 3. Estimated Income Elasticities from 8-Segment Piecewise Linear Spline

Income Range (1999\$)	Energy Consumption	Energy Production	Consumption CO ₂	Production CO ₂
< \$8,644	1.22 (0.27)*	0.51 (0.37)	1.31 (0.38)**	0.46 (0.51)
		6.93**		6.59*
\$8,644 – \$10,732	0.82 (0.11)**	0.87 (0.16)**	0.60 (0.16)**	0.73 (0.21)**
		0.22		0.88
\$10,732 – \$13,323	0.60 (0.067)**	0.50 (0.094)**	0.29 (0.097)	0.079 (0.13)
		2.03		6.15*
\$13,323 – \$16,541	0.64 (0.054)**	0.52 (0.076)**	0.33 (0.078)**	0.20 (0.10)*
		4.15**		3.20*
\$16,541 – \$20,537	0.55 (0.051)**	0.30 (0.072)**	0.26 (0.074)**	-0.053 (0.098)
		23.09**		24.38**
\$20,537 – \$25,497	0.26 (0.054)**	-0.24 (0.076)**	-0.15 (0.079)	-0.76 (0.10)**
		81.51**		79.53**
\$25,497 – \$31,655	0.12 (0.070)	-0.53 (0.099)**	-0.35 (0.10)**	-1.16 (0.13)**
		84.21**		85.10**
> \$31,655	0.53 (0.19)**	-0.23 (0.27)	-0.089 (0.28)	-1.00 (0.37)**
		14.92**		14.18**

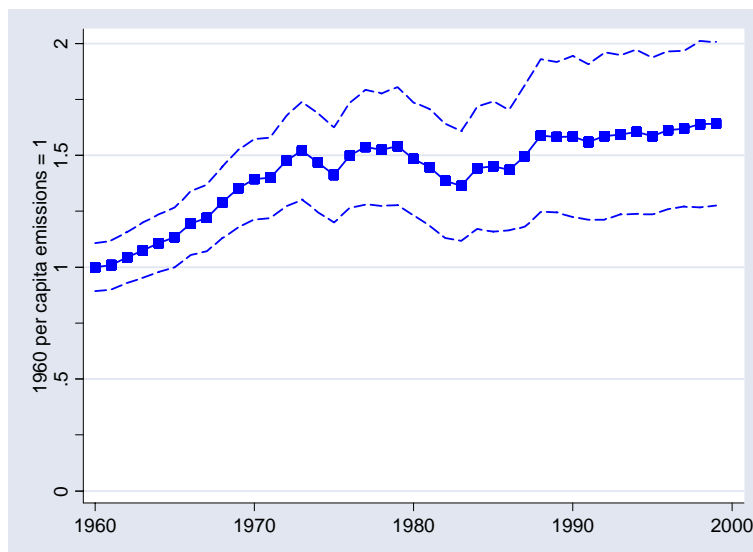
Notes: Dependent variables are natural logarithm of per capita measures listed in the first row. The two energy (CO₂) measures were modeled as a 2-equation system to allow for correlation in the residuals across measures. The table presents the natural logarithm of per capita income coefficient estimates and robust standard errors (in parentheses) for each of eight income ranges (spline segments). All specifications include year and state fixed effects. Below each consumption-production pair of income elasticities for a given income range are the Wald test statistics for the hypothesis that the pair of elasticities are equal. These statistics are distributed F(1, 1825). *, ** denotes statistical significance at 5 and 1 percent critical levels, respectively. N = 1,920.

Figure 1. States' average energy consumption per capita, 1960–1999



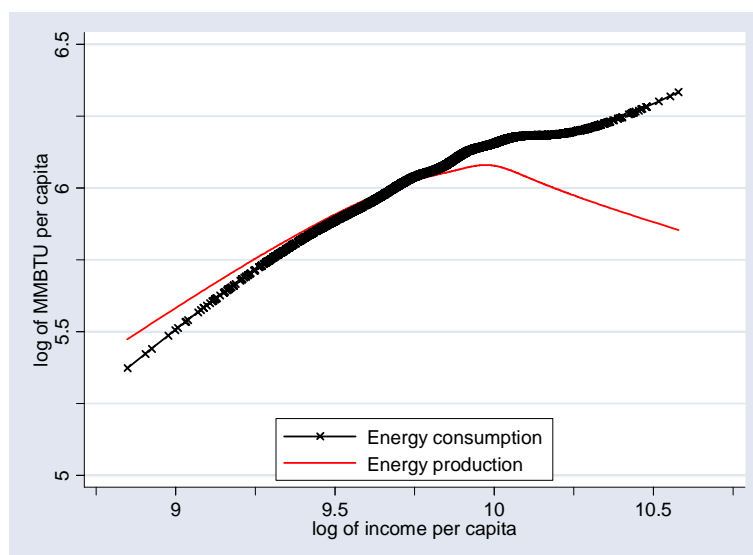
Notes: Average energy consumption per capita for the continental 48 states for all sources of energy. Constructed by author with data from EIA (2001b). Dashed lines represent the 95 percent confidence interval.

Figure 2. States' average carbon dioxide emissions per capita, 1960–1999



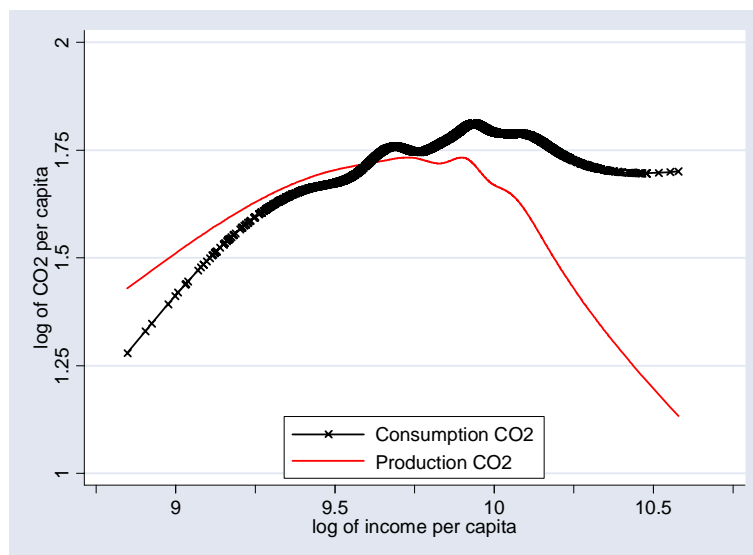
Notes: Average production carbon dioxide emissions per capita for the continental 48 states. Constructed by author with data from EIA (2001a, 2001b). Dashed lines represent the 95 percent confidence interval.

Figure 3. States' production and consumption energy-income relationships, 1960–1999



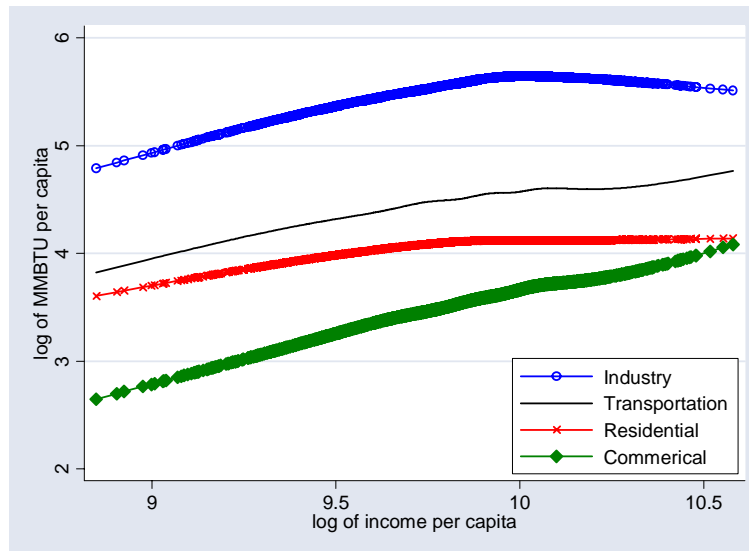
Notes: Functions derived from regressions of the natural logarithm of per capita energy on cubic spline functions of the natural logarithm of per capita income and state and year fixed effects. Based on specification tests, this figure presents the 5-knot cubic spline function for energy consumption and the 8-knot cubic spline function for energy production. N = 1,920.

Figure 4. States' production and consumption CO₂-income relationships, 1960–1999



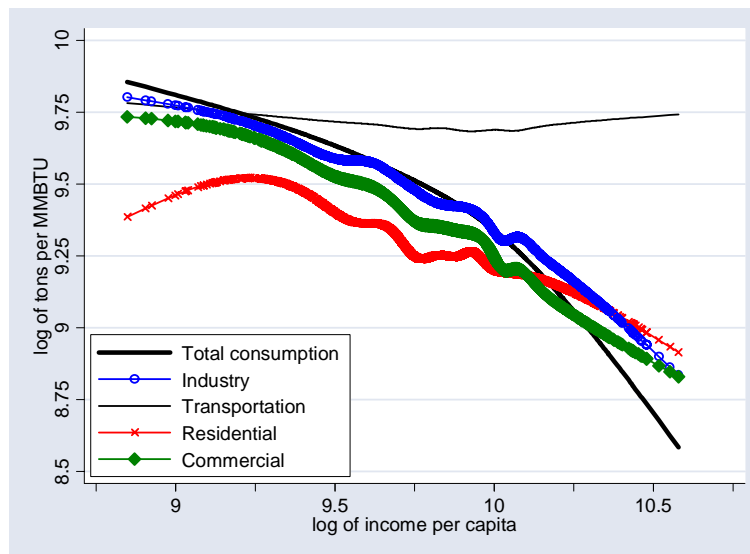
Notes: Functions derived from regressions of the natural logarithm of per capita emissions on cubic spline functions of the natural logarithm of per capita income and state and year fixed effects. Based on specification tests, this figure presents the 11-knot cubic spline function for consumption CO₂ and the 8-knot cubic spline function for production CO₂. N = 1,920.

Figure 5. Sectoral energy–income relationships, 1960–1999



Notes: Functions derived from regressions of the natural logarithm of per capita end-use energy on cubic spline functions of the natural logarithm of per capita income and state and year fixed effects. Based on specification tests, this figure presents the 4-knot cubic spline function for the industrial sector, the 8-knot cubic spline function for the transportation sector, the 3-knot cubic spline function for the residential sector, and the 7-knot cubic spline function for the commercial sector. $N = 1,920$.

Figure 6. Carbon/energy–income relationship, 1960–1999



Notes: Function derived from regression of the natural logarithm of the carbon-energy ratio on cubic spline functions of the natural logarithm of per capita income and state and year fixed effects for total energy consumption and for consumption in each major end-use sector. Based on specification tests, this figure presents the 10-knot cubic spline function for total energy consumption, 4-knot cubic spline function for the industrial sector, the 8-knot cubic spline function for the transportation sector, the 3-knot cubic spline function for the residential sector, and the 7-knot cubic spline function for the commercial sector. $N = 1,920$.