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Carbon tax rising?

Shi-Ling Hsu

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It might seem odd these days to be considering the possibility of carbon taxes as climate policy. But there is the distinct possibility that states will address climate change as the federal government abandons this policy area. Second, there remains the faint hope that the Trump administration or Congress will recognize carbon taxation as a vehicle for tax reform. Many, many policy experts, economists, and environmentalists have long been arguing that carbon taxation is the least costly and most effective way to reduce carbon dioxide emissions. But less commonly discussed is the fact that carbon taxation offers the opportunity to address a number of non-environmental objectives, such as fiscal reform, infrastructure funding, or reducing inequality.

A carbon tax is a unitary tax on actual carbon dioxide emissions. Carbon taxes can be levied upstream, at the point of extraction, refining (of oil), or distribution, or downstream, at the gasoline pump or as an addition to an electricity or heating bill. A carbon tax can be expanded to include other greenhouse gases, as long as the tax on emissions of these other greenhouse gases is calibrated depending on those gases' warming potential, using carbon dioxide as an index. In practice, carbon taxes are limited to consumption of refined gasoline, fossil fuel-generated electricity, and household and industrial uses of common natural gas and heating oil. Such a simple carbon tax generally covers the vast majority of carbon dioxide emissions.

A carbon tax is effective in reducing emissions and is also economically efficient. Carbon taxes can be applied very broadly and simply, as the tracking and taxation of fossil fuels is already quite routine. Because a carbon tax would build on existing regulatory infrastructure, the certainty that it will succeed in reducing emissions instead of bogging down in litigation is very high. Moreover, a carbon tax scales proportionately with the amount of emissions, so that it takes account of the different contributions that different fossil fuels make to climate change. Burning coal, which produces roughly twice the carbon dioxide emissions as burning natural gas, would be subject to twice the tax. That is how environmental law should work: the impetus to curtail an activity should be weighted by its environmental harm. As a side benefit, reducing emissions from coal extraction, transport, and combustion would also generate a number of health benefits unrelated to climate change, such as a reduction in respiratory diseases and deaths from cardio-pulmonary diseases. A carbon tax is not the only climate policy that would reap those health benefits, but it best internalizes these social costs to the emitter.

Breadth of application and accurate scaling also ensure that carbon taxation reduces emissions at the lowest cost. A carbon tax ripples across the entire economy, and up and down production chains, so that it is an accurate measure—and price—for a total end-product carbon footprint. As such, it will broadly recruit efforts to find efficiencies and reduce emissions, with the most attention being paid to where reductions are the greatest and cheapest. Critically, carbon taxation is agnostic as to specific strategies or technologies; there is no favoritism for a technology that will support the economy of an important swing state. What many other climate policies do—which makes them irresistible to politicians—is pick winners and losers. A carbon tax is the way to have *markets*, not politicians, determine which strategies or technologies best reduce emissions, and at the lowest possible cost.

On the rare occasions in which carbon taxation has been proposed, it has withstood withering assaults based on misleading assertions from the fossil fuel industry and its allies. Somewhat surprisingly, objections have also come from the political left, and not without reason. By itself, carbon taxation is regressive, hurting poor households more than wealthy ones. While wealthy households generally consume more energy and have a larger absolute carbon “footprint,” energy expenses occupy a larger *share* of a poor household’s budget and are thus more painful for the latter.

Climate change deniers and the fossil fuel industries, sowing discontent among the poor, would have you stop your analysis there. But to do that is to speciously assume that carbon tax revenues would be gathered together in a pile of bills and burned. A federal carbon tax of, say \$40 per ton of carbon dioxide, would produce first-year revenues of at least \$200 billion, which could go a long way towards reducing the financial impact to lower-income households, reducing distortionary taxes, such as corporate or personal income taxes, and even providing relief to industries and communities suffering disproportionately from the decline of fossil fuel use. If lawmakers wish to protect the lowest-earning 60 percent of households from carbon taxation, less than half of the proceeds would be needed to insulate them from any net loss. A carbon tax “rebate” could be in the form of a lump sum distribution or any number of other tax credits targeted towards lower income taxpayers. There would still be money left over for other priorities.

Fiscal benefits could make carbon taxation an especially attractive option at the state level. Washington State, for example, spurred by a failed but surprisingly popular carbon tax ballot initiative, has proposed a carbon tax that would provide funding for its chronically underfunded public schools. Other cash-strapped states might decide that a 40-cent-per gallon gas price increase (the product of a \$40 per ton carbon tax) might not anger motorists quite as much as continuing cuts to social services, education, or road maintenance. At levels currently discussed, a carbon tax is a relatively low but very broad tax, raising large amounts of revenue in small amounts, and minimizing economic disruption. For those people or industries that are disproportionately impacted, the revenues are generally large enough to provide meaningful compensation.

A carbon tax is unappealing, just because it is a tax. But lawmakers would do well to heed the call of Republican statesmen James Baker III and George P. Schultz, as well as prominent conservative economists Martin Feldstein and Gregory Mankiw, all of whom have recently called for a carbon tax. Once lawmakers accept that there are no free lunches, the simplest solution will reveal itself to be the best solution.