Economy

With ‘fiscal cliff’ looming, carbon tax getting closer look

By Steven Mufson  November 9, 2012  Follow @StevenMufson

Here’s a riddle: If Congress doesn’t want to raise income tax rates but wants to raise revenue, what can it do?

One answer: Pass a carbon tax.

A relatively moderate-sized carbon tax could raise $1.25 trillion over the next decade, a huge chunk of the money needed to bring the federal budget deficit under control. And the idea is getting a closer look now that the election is over and the “fiscal cliff” is looming.

Because it would tax fossil fuel use, the carbon tax pleases economists who want to encourage investment and discourage consumption. Climate activists hope it would reduce greenhouse-gas emissions by penalizing the use of coal, oil and natural gas. And for lawmakers opposed to any change in tax rates or deep cuts in spending, the carbon tax could be a lifeline.

“In the general scheme of things, taxes discourage whatever you’re taxing,” said William Pizer, associate professor of economic and environmental policy at Duke University. “If something is discouraged, it might as well be something bad like pollution instead of employment and savings.”
Pizer said that a $20-a-ton tax on carbon dioxide would raise gasoline prices by about 20 cents per gallon and boost electric bills slightly. It could be most efficiently collected “upstream,” at coal mines, oil and gas wells, or terminals for oil tankers arriving at U.S. shores.

There are drawbacks. Higher prices fall most heavily on lower-income earners who spend a larger portion of their pay on fuel. The tax would hurt certain regions more than others. It would need to be tweaked to protect firms that export to countries where companies don’t pay any carbon tax. It would also have to be reconciled with existing carbon trading schemes in the Northeast and California.

“Taxation is a painful thing, but this is one of the least inefficient ways of raising taxes,” said Nick Robins, head of the climate change center for banking giant HSBC. “At a time of low economic growth, it can be quite a good thing because it is taking costs out of the economy. If you can do that, it would be a good thing.”

As a matter of negotiating strategy, now might be a bad time for the Obama administration to advertise interest in a carbon tax. Doing so would make it a “lightning rod,” said Pizer, a former Treasury official. But, he added, once people see the pros and cons of other taxes and once they reach an impasse and need more revenues, a carbon tax might be an attractive alternative.

“From a policy-making point of view, it is clear that there is no way that this Congress is going to glom onto a carbon tax as an environmental policy,” said Philip R. Sharp, who served two decades in the House and is now president of Resources for the Future. “But it could become an important enabler for other things the Congress wants to do, namely eliminating the deficit and tax reform.”

In the past, conservatives have supported the idea of a carbon tax, though most of them have opposed using the receipts to swell government coffers.

N. Gregory Mankiw — a Harvard University economics professor, adviser to GOP
presidential nominee Mitt Romney and former chairman of President George W. Bush’s Council of Economic Advisers — has long supported a carbon tax because he says the price of fossil fuels doesn’t reflect their true societal costs. In the past, he said he would use the receipts to lower other taxes.

In 2007, Kevin Hassett of the American Enterprise Institute, said a carbon tax would not only help energy security and attack global warming, it could also raise a quarter as much revenue as the corporate income tax and could be used to cut those rates.

In 2009, Exxon Mobil chief executive Rex Tillerson — in part to slow momentum toward a cap-and-trade system for reducing greenhouse-gas emissions — endorsed the carbon tax and said it should be set “somewhere north of” $20 a ton.

“As a businessman it is hard to speak favorably about any new tax. But a carbon tax strikes me as a more direct, a more transparent and a more effective approach,” he said at the time. He added that “a carbon tax is also the most efficient means of reflecting the cost of carbon in all economic decisions — from investments made by companies to fuel their requirements to the product choices made by consumers.”

But he, too, said it should be revenue neutral.

One leading GOP advocate of the carbon tax just flipped position. House member and Sen.-elect Jeff Flake (R-Ariz.) co-sponsored a carbon tax bill in 2009. But Friday, a spokesman told The Hill newspaper that Flake “has no plans to reintroduce it or support it as part of a tax reform package.”

The American Petroleum Institute (API) opposes a carbon tax. “Anytime we look at an energy issue, be it a tax or regulatory issue, we ask what does it do to promote or inhibit energy production and what is the impact on the American people,” said Jack Gerard, API president. “Clearly, it would increase costs to the American public. Is that what he [President Obama] wants to do? I would think not.”

But compared to the fiscal cliff, even a carbon tax might look attractive. A study by the Massachusetts Institute of Technology said “the economy is better off with
the carbon tax than if taxes remain high to maintain Federal revenue.”

“We’ve been just surprised at the number of political groups across the political spectrum considering this,” said Sharp of Resources for the Future. “Contrary to what almost everybody universally would have said two years ago, we have gotten ourselves in such a pickle on the fiscal side of things that it opens up the possibility.”

Steven Mufson covers the White House. Since joining The Post, he has covered economics, China, foreign policy and energy.
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