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Washington State Ballot Proposal Shows Why the Right Should Reject a Carbon Tax "Deal"

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For several years, a small but vocal group of public intellectuals have urged conservatives and libertarians to support a carbon tax "deal," in which the Democratic Left will agree to reduced regulations and corporate tax relief, in exchange for a new carbon tax. The people pushing such a deal to the Right have gone so far as to say even if you think climate change isn't a big worry, nonetheless the right "carbon tax swap" will be good for the economy.

I have written extensively on why these promises are false, for reasons of economic theory as well as political reality. (Here ismy IER critique of carbon tax swap deals, and here is my recently published Cato study with climate scientists on problems with a carbon tax.) Yet we can also look at a recent Vox article discussing the drama behind Washington State's ballot initiative for a carbon tax, to see why conservatives and libertarians should have no business cutting a "deal" with the Democratic Left. The fact that the Vox piece is written by a supporter of carbon taxes shows this is not mere axe-grinding.

Environmental Groups Do *Not*Agree to Revenue Neutral Carbon Tax

The single most important takeaway from the Vox piece is the fact that the progressive Left will *not* agree to a carbon tax, if they don't get their hands on the new money. Consider this choice excerpt from the article:

[T]he [Alliance for Jobs and Clean Energy]'s core objectionto [carbon tax ballot initiative] I-732 is that it is revenue-neutral —it surrenders all that precious revenue, which is so hard to come by in Washington. That, more than anything else, explains why alliance groups are not supporting it.

Their calculus is simple: Properly dealing with climate change requires lots of investment, and if a price on carbon doesn't fund that investment, what will? Given how difficult it is to raise revenue in the state, the idea, often put forward by I-732 proponents, that greens can simply find that money somewhere else is, in the alliance's view, naive to the point of malice.

Labor groups want investments to incentivize green manufacturing and retrain displaced workers. Communities of color and low-income groups want "a share of the money to go to the infrastructure that we need to weather climate change," says Schaefer, like affordable housing near public transit. Tax cuts and credits "are not going help the folks I work with go out and buy a [Nissan] Leaf," Schaefer says.

...

This was always the alliance's message to CarbonWA: Revenue neutrality loses you the left coalition, and with it the big left funders, and doesn't gain you any Republicans. [Bold added.]

The above analysis—coming from Vox's resident climate expert, who is very concerned about climate change—should put to bed the pundits telling conservatives and libertarians to "strike a deal" with the progressive Left on a carbon tax. They are making it quite clear, both in terms of wonkish articles and boots on the ground, that they will *not* agree to such a deal. It is amazing that there are still a few people shopping this "deal" around to people on the Right.

Why Carbon Taxes—Even if "Revenue Neutral"—Can Hurt the Economy

In the above discussion, I may have given the impression that Washington State's carbon tax proposal—which was explicitly designed by environmental economist Yoram Bauman—*would* be economically beneficial, *if only* those intransigent Leftists would support it. Let me disabuse the reader of such an illusion. *Even on its own terms,* the Washington State carbon tax proposal would hurt the economy. But to explain why, I need to first present some background on the economic literature.

Because a carbon tax interacts with pre-existing taxes, it actually amplifies their destructive power. The so-called "tax interaction effect" explains why even a revenue-neutral carbon tax can end up harming economic growth, even if one thought there were modest environmental damages from greenhouse gas emissions. This is why standard models—see here and here for analysis from Resources for the Future (RFF), an organization which is sympathetic to a carbon tax—show that only *very specific uses* of carbon tax revenue *could even theoretically* be used to offset the drag to economic growth.

Specifically, standard models show that all of a new carbon tax's revenue would have to be devoted to very "pro-growth" channels to counteract the prima facie damage from making energy more expensive. For example, if all of a new carbon tax's revenue were devoted 100 percent to reducing the corporate income tax, then *maybe* the conventional economy (which just counts goods such as TVs, computers, cars, houses, etc. but ignores environmental quality) would grow faster than in the status quo, and we would also get whatever environmental benefits accrued as a bonus.

However, under any politically plausible scenario, the standard modeling shows that a carbon tax would *hurt*conventional economic growth. Even if, for example, a new carbon tax's receipts were devoted entirely to payroll tax relief, or even if all the receipts were returned to taxpayers in lump-sum transfers, then the baseline result in the peer-reviewed literature is that traditionally-measured GDP growth would slow. (To be sure, one might still support a carbon tax in this scenario, but it would have to be for environmental reasons, *not* because the tax change was "good for the economy.")

Washington State Carbon Tax Proposal Would Hurt the Economy

With this context in mind, let us consider the Washington State carbon tax ballot proposal, which was designed by an environmental economist (Yoram Bauman). As the Vox article explains, initiative I-732 would:

- Impose a tax on carbon emissions, starting at $15 per ton in 2017, rising to $25 per ton in 2018, and then rising every year thereafter at 3.5 percent plus inflation, topping out at $100 a ton (in 2016 dollars). The tax would reach citizens in the form of a gas tax and a tax collected by electric utilities.
- Reduce the state sales taxby 1 percentage point.
- Fund the working families tax rebate (WFTR), which would bump up the federal earned income tax credit to provide up to $1,500 a year for 460,000 low-income households.
- <Eliminate the business and occupation taxon manufacturing.

Notice that only some of the carbon tax revenues would be devoted to lowering taxes on businesses. Much of the revenue would instead be devoted to offsetting the impact of higher energy prices on poor households.

Now to be sure, this might be the *fair* thing to do; the poor are hardest hit by higher energy prices, which a carbon tax will certainly deliver. But my point is that even this ostensibly "ideal" revenue-neutral carbon tax, explicitly designed by an environmental economist, would actually be bad for conventional economic growth, according to standard modeling in the literature. Indeed, conventional tax analyses think that a sales tax is a relatively *innocuous* form of raising revenue, as compared to taxes on labor or capital income. So levying a stiff tax on a small sector of the economy—namely, carbon-intensive operations—while reducing the broad-based state sales tax, clearly makes the tax code*more* distortionary, if we are considering only conventional tax analysis.[1]

WA State Carbon Tax Assumes Worldwide Compliance

But things get even worse. Even if we take the threat of climate change seriously, then the Washington State carbon tax proposal is far too aggressive.

According to the formula described in the quotation above, the Washington proposal would tax carbon dioxide at a price of about $75 per ton in the year 2050, measured in 2016 dollars, which is about $65 measured in 2007 dollars. This is a bit higher than what the Obama Administration most recently estimated the "social cost of carbon" to be (using a 3 percent discount rate), but it's close enough for government work.

Yet hold on, there's a serious problem here. The analysis underlying the "social cost of carbon" implicitly assumes that the associated tax is levied *globally*. If instead only some jurisdictions levy the carbon tax, then we have to worry about "leakage"—when businesses and individuals transfer their emissions to outside, untaxed jurisdictions.

It should be clear that Washington State itself levying a carbon tax, even a draconian one, will not significantly affect*global* greenhouse gas emissions, particularly over the course of decades. As such, the "optimal" carbon tax when a state like Washington acts unilaterally is much lower than what the concept of the "social cost of carbon" implies. To repeat, I am here merely walking through the logic of the textbook treatment of climate change economics; I'm not bringing up practical or political objections. (The Vox article itself shows a chart indicating that the state of Texas alone has about *nine times* the carbon dioxide emissions as Washington State.)

For an analogy, suppose someone saw people dropping litter on a beach, and wanted to levy a fine to discourage this behavior. Now people could argue about the appropriate size of the fine; make it too little, like 10 cents per infraction, and it wouldn't solve the litter problem. But make it too big, like $10,000 per infraction, and tourists might stop going to the beach altogether for fear of accidentally losing a napkin in the wind and having to pay a huge penalty.

Yet we can all agree that whatever the "right" level of the fine would be, it would be nonsense to apply that same dollar fee *to only a small section of the beach* that covered, say, one-one thousandth of the total surface area of the sand. It is clear that such a policy would be idiotic, because people would simply make sure not to set up their blankets on that tiny fraction of the beach, and would otherwise continue with their normal behavior.

This is analogous to Yoram Bauman's proposal. His carbon tax would apply to Washington State, which has about 0.3 percent of the total habitable land surface area of planet Earth. Now it's true, Bauman and other environmental crusaders think that group action must first start at the state level, and over time other jurisdictions may follow suit. But we should still point out that on its own terms, the Washington carbon tax proposal is still far too high. Advocates are mixing in hopes that they will achieve copy-cat policies all over the globe in order for their suggestion to make any sense, even taking their own climate models as given.

Conclusion

The civil war on the Left over the Washington State carbon tax ballot proposal shows just how naive and dangerous are the calls for a grand "bargain" whereby conservatives and libertarians agree to a carbon tax in exchange for promised corporate tax relief and deregulation. The groups who would have to go along with such a bargain are making it crystal clear that they want nothing to do with it.

Additionally, the people in Washington State should make sure they understand that their carbon tax would make energy for them more expensive, but would only serve as a token gesture, which requires other governments around the world to follow suit if it is to have any effect on the global climate. Finally, let me remind readers that all of my pessimism stipulates the underlying climate computer models at face value; I am merely reminding people of how much more is necessary to justify a stiff carbon tax at the state level.

[1] To repeat, if someone thinks humanity is on the brink of catastrophe and that a massive carbon tax is necessary to come back from the ledge, then these proposals might make sense. But conservatives and libertarians are being urged to support Washington State-style carbon taxes even if they think Al Gore is bluffing.