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Do We Need New Climate Change Guidelines?

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What, if anything, should the United States do about climate change?

One possibility, embodied in President Obama's Climate Action Plan, is to double-down on current policies, which include fuel economy standards for motor vehicles, efficiency standards for household appliances, subsidies for "clean" energies like wind and solar, mandates for biofuels like ethanol and carbon pollution standards for power plants.

'Ideal' carbon tax

By raising prices for gasoline, coal and oil, an ideal carbon tax causes substitution of greener alternatives, thus reducing carbon emissions, according to the Cato Institute's Jeffrey Miron. Higher fossil fuel prices also incentivize research on alternatives.

These policies tend to reduce carbon emissions, but they are blunt instruments for achieving that goal. Enhanced fuel or energy efficiency standards impact new purchases of cars and appliances but not existing stocks. Subsidies for clean energy require government to be a venture capitalist, despite abundant evidence that government does this badly. Bio-fuel mandates do not appear to reduce carbon emissions because they deplete carbon dioxide-consuming forests. Carbon pollution standards for power plants are difficult to monitor and enforce.

More broadly, "command and control" policies do not readily balance emissions reductions against the costs of achieving these reductions. Some reductions are easy to achieve, while others are difficult, so an ideal policy obtains the biggest reductions from sources that require the smallest costs. Complicated rules imposed by bureaucrats at multiple government agencies do not lend themselves to this balancing.

An alternative approach is to replace all these command-and-control policies with a revenue-neutral carbon tax. That is, eliminate the entire command-and-control apparatus; increase or impose new taxes on fossil fuels; and lower other tax rates so as to leave tax revenue unchanged.

A carbon tax is far simpler to enforce than command-and-control policies. It is straightforward to compute the extra carbon cost generated by the tax, so this can be balanced against the estimated benefits of reduced carbon emissions. In addition, a carbon tax raises revenue, which means the U.S. could lower other tax rates while holding total revenue constant.

The economics of how best to address climate change is therefore clear. Why, then, has the U.S. not adopted this approach?

One possibility is that the scientific case for costly global warming is not compelling, but I'll leave that aside for now. A second possibility is recognition that even ideal carbon taxation makes the U.S. a less competitive location for businesses, since it is impossible to force other countries to adopt similar carbon taxes (or even to reduce their existing carbon subsidies). If the U.S. goes it alone in reducing emissions, the net impact on global warming will be minor.

Moreover, political constraints make the ideal carbon tax virtually dead-on-arrival.

Conservatives are skeptical because they doubt Congress will adopt the ideal approach and instead just add a carbon tax on top of current command-and-control policies, while failing to lower other tax rates to achieve revenue-neutrality.

Such a non-ideal carbon tax would have several negatives. It would fail to eliminate the bureaucratic waste, rent-seeking, inefficiencies and corruption that command-and-control policies generate. Plus, adding carbon taxes on top of these policies risks overkill in addressing climate change; the estimated risks, even if 100 percent accurate, suggest moderate increases in carbon prices, not unlimited attempts to punish carbon.

Failure to keep revenue neutral also foregoes a key benefit of the ideal carbon tax. And, extra revenue might generate additional expenditure, which some conservatives oppose on principle and others oppose unless they are confident it will be spent in their own districts.

Liberals, with some exceptions, oppose carbon taxation. They fear voters will not support climate policies whose costs are explicit; voters seem to prefer command-and-control policies that appear free or that claim to impose the costs only on businesses. And some liberals like the power they obtain from rewarding special interests or favored donors with loan guarantees, ethanol mandates and the like.

Independent of party affiliation, moreover, politicians from coal or oil-producing states oppose carbon taxation because it will adversely impact their constituents.

The prospects for an ideal carbon tax are therefore remote, which leaves three choices: more command-and-control; a non-ideal carbon tax; or just sticking with current policy, as imperfect as it is. The third alternative — do no (new) harm — is probably the best choice.

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