

Pro-Growth Carbon Tax Policy 101

- We face a **fundamental policy choice** if America is to transition to a clean-energy economy. One path - the one we are currently on - is regulatory. This path is costly, complex and inefficient, with widely differing mandates by sector and across federal, state, and local levels.
- The alternative path would be **market-based**, relying on the principle that the most efficient approach places an economy-wide price on carbon emissions but allows economic actors the freedom to decide how to respond to that price. The simplest way to do this, a carbon tax, **provides incentives** for businesses and consumers to find the least-cost way to reduce carbon emissions. The tax leads businesses to innovate, use cleaner energy sources, and invest in more carbon-efficient production techniques, and it provides an incentive for households to conserve on their consumption of goods and services broadly in relation to those items' carbon-intensiveness.
- The market-oriented approach would **make unnecessary the more costly regulatory approach to addressing climate change**, including the proposed power plant regulations put on hold by the Supreme Court.
- A carbon tax could be levied at an upstream stage of the production process, generally where energy enters the economy. This would be highly **administratively efficient**, with approximately 80% of U.S. emissions covered by collecting the tax from a relatively small number of sources, around 2,300. Close to 90% coverage can be achieved at an acceptable cost by levying the tax on approximately 6,000 sources.
- The carbon tax would be levied per ton of CO₂-equivalent, with the tax per ton set into the future, typically rising over time on a specified path (though there could be periodic adjustments, over a long time cycle, for changes in science or economics). This would **provide more certainty for businesses** to adapt their activities to the new regime and spur innovation such as carbon-reducing technologies.
- The experience of carbon taxes and similar approaches in other countries, supported by economic research, suggests that a carbon tax would make a meaningful and, arguably, appropriate contribution toward reducing U.S. carbon emissions and accelerating the transition to a clean energy economy at a lower cost to society than through complex regulations.
- Adding trade rules in conjunction with a U.S. carbon tax could help accelerate the needed movement by other nations to develop their own carbon pricing mechanisms, in a way that regulations cannot. Such trade rules would also allow U.S. firms to compete on a level playing field against firms in countries that do not have a carbon tax or other restrictions on carbon emissions.

- Under most proposals, a carbon tax would generate around \$100 billion per year in the first decade and more in subsequent years. This could allow for a reduction in the corporate tax rate that would offset all or most of the impact of the carbon tax on GDP. Indeed, many studies find that the economic benefits of tax reform outweigh the impacts of the carbon tax, resulting in a net increase in overall income.
- Using a relatively small share of the tax revenue to help offset the impacts on lower-income families and on affected regions such as coal communities could be done while still leaving sufficient resources to allow for meaningful pro-growth tax reform.

—By Ted Gayer and Phillip Swagel

Ted Gayer is Vice President of the Economic Studies Program at the Brookings Institution. He was previously an Economist at the Council of Economic Advisers and Deputy Assistant Secretary of the Treasury for Economic Policy, both in the administration of President George W. Bush.

Phillip Swagel is Professor of International Economic Policy at the University of Maryland School of Public Policy. He was previously chief of staff at the Council of Economic Advisers and Assistant Secretary of the Treasury for Economic Policy, both in the administration of President George W. Bush.