

Time to give up on a carbon tax?

April 27 2021, by Ben Ho



Credit: Pixabay/CC0 Public Domain

Since 2006, economist and former Bush-era White House adviser Greg Mankiw has been encouraging economists and policy makers to join the Pigou Club, which advocates for a tax on carbon. The idea goes back to economist Arthur Cecil Pigou, who, in 1920, proposed to tax market activities that generate externalities—costs that are not included in a

product's market price, such as the healthcare costs of using tobacco. In the case of carbon, such a tax would raise revenue for the government while making sure those who choose to burn fossil fuels (say, when you drive your car to work) adequately take into account that choice's damage to the environment and the health and safety of others.

Although fundamentally a good idea, carbon tax proposals have repeatedly failed to gain political momentum—and they may not even be the best solutions available. Maybe it's time to retire the Pigou club.

A carbon tax is an idea with some consensus from economists on both the right and the left. It's an easy sell for most Democrats, since it increases government revenues while working to fix climate change, but it's also appealing to Republicans because the revenue it raises would allow the government to cut taxes on things we want more of, like income and investment. Also appealing to free market types, no bureaucrat or congressional lobbyist would be picking which companies win or lose in the marketplace. The government simply sets a price that allows consumers and firms to make the right choice when deciding how much to pollute—it lets the market decide. Little wonder this idea has gotten [support from prominent Republicans](#).

Despite its advantages, the U.S. has seen little progress in passing a carbon tax. Some conservatives dislike the imposition of a tax that would likely produce a massive (e.g., trillions of dollars) source of new government revenues that might be used poorly. Conservatives also worry about the harm it would cause to workers in fossil fuel industries and the increased prices faced by consumers. Liberals also object to the higher prices, which could disproportionately harm those with the lowest incomes.

In 2018, a tax designed to fight climate change in France led to weeks of violent "yellow vest" protests against rising fuel prices, among other

concerns, causing the French government to back down. A plan for an E.U.-wide carbon tax has never been successful. Recent referenda in Washington State have failed again and again. In fact, no U.S. state has successfully passed a carbon tax (although many U.S. states and the E.U. have passed cap and trade policies).

Because for all of their vaunted benefits, carbon taxes have substantial drawbacks. I suspect that a carbon tax would be less transformative than its advocates promise. Economists Kenneth [Gillingham](#) and James [Stock](#) find we already have dozens of existing policies that place high implicit prices on carbon reductions: e.g. renewable portfolio standards that regulate electricity (with an implicit carbon price of \$0-\$190/ton), tax credits for solar power (\$140-\$2100/ton) or wind (\$2-\$260/ton), fuel economy standards (\$48-\$310/ton), corn ethanol standards (\$-18 to \$310/ton), or subsidies for electric cars (\$350-\$640/ton). The additional impact of a carbon tax at say the \$51/ton [social cost of carbon](#) recently adopted by the Biden administration could have a smaller effect on these specific sectors relative to the policies already in place. It is true that a carbon tax would incentivize reductions in other sectors, but there are few major sources of carbon emissions in the U.S. that aren't already regulated by existing policies.

A carbon tax on its own isn't even the first best policy option because it doesn't target other externalities that are potentially more important than the direct damage of [climate change](#). In particular it doesn't do enough to encourage the benefits that come when new technologies are invented, such as the innovations that have brought the price of solar down by 90% or more in the past 10-20 years. It also does little to address the infrastructure needed for a low carbon economy—infrastructure like a smarter grid, or a network of electric vehicle charging stations. Perhaps we should be focusing on those market failures first. For example, the innovation and network benefits associated with buying an electric car today is far greater than the direct benefit from reduced use of [fossil](#)

[fuels](#). Buying an electric car today does have a direct effect on reducing emissions, but the indirect effect of making electric cars affordable to all may be far more important.

In many ways, the types of policies that politicians tend to favor—policies that heavily target innovation and then phase out (such as subsidies for solar electricity or electric vehicles) or infrastructure projects like power grid upgrades—are preferable to Pigouvian taxes. Especially since the biggest political hurdle is getting international buy-in—getting countries like India, Nigeria and Saudi Arabia to adopt climate-friendly policies as well. Yes, passing a U.S. carbon tax might encourage other countries to pass similar policies of their own, but a more effective way to get other countries to go green could be to spur innovations like the ones that [have made solar one of the cheapest forms of energy in much of the world](#) and [electric cars](#) a viable alternative to gasoline-powered ones. While these seemed like pipe dreams not long ago and advocates were derided as techno-optimists, these goals now seem readily within reach (for example, [GM just announced it plans to end production of gasoline powered cars by 2035](#) in favor of electric). Maybe it's time to redouble our efforts.

It's not that a carbon tax is a bad idea; in an ideal world, Pigouvian taxes are still part of a first-best policy solution. A uniformly applied [carbon tax](#) has benefits that the current hodge-podge of targeted government programs just doesn't. A clear price on [carbon](#) would encourage innovation in areas the government has never heard of, and create a [much more efficient channel for government revenues than distortionary taxes on income and capital](#). It's just that there are other externalities with higher potential impact that maybe we should be focusing our attention on, especially since there are political costs that make subsidies and infrastructure projects more attractive than a massive tax increase. I am still a supporter of the Pigou club, but maybe it's time for the club to rethink its plan of action.

This story is republished courtesy of Earth Institute, Columbia University
<http://blogs.ei.columbia.edu>.

Provided by Earth Institute at Columbia University

Citation: Time to give up on a carbon tax? (2021, April 27) retrieved 29 April 2024 from
<https://phys.org/news/2021-04-carbon-tax.html>

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.