**Insight**

# Revenue Neutral Carbon Tax Buzz

**CATRINA RORKE | NOVEMBER 19, 2012**

Standalone climate legislation seems exceedingly unlikely.  The parties cannot come to agreement on whether Congress *should* act to limit carbon, let alone what solutions are most appropriate.    Recent buzz over a carbon tax highlights what could be the outlines of a narrow agreement: using a revenue-neutral carbon price to buy down tax rates and spur economic growth. But despite the economics and the timing lining up, the politics remain daunting.

To limit carbon output, there's much to commend a carbon tax.  At its simplest, it would be a mechanism that forces the market to recognize the social cost of greenhouse gas emissions and enables efficient decision making about how to reduce behavior that creates emissions.  Pricing the global warming externality would render unnecessary existing government subsidies and regulatory programs that push alternative energy and energy efficiency.  The market, seeing a profit opportunity, would innovate low-carbon solutions that can't currently compete with the low cost of incumbent fossil fuels.

Naturally, a carbon tax could generate a large pot of money.  Dedicating that revenue to reducing other inefficient forms of taxation could not only diminish the contractionary nature of a new tax, but actually help expand the economy.  Shifting taxation to something we want less of – carbon emissions – lets us reduce or eliminate distortionary taxes in our economy that drag down incentives to work, save, and invest.  Art Laffer has made this argument many times – often with his neighbor Al Gore – as have Greg Mankiw and Irwin Stelzer.

The EPA is churning out a series of expensive, heavy-handed regulations to suppress carbon emissions from vehicles, electric facilities, and resource development.  Without Congressional action on climate change, the EPA will continue to use the Clean Air Act as a blunt tool to force carbon out of our economy.

This year, the U.S. corporate income tax became the highest in the developed world, and we continue to struggle with a persistently sluggish economy.  Comprehensive corporate tax reform is long overdue.  Broadening the tax base and eliminating cumbersome credits and preferences in the code go a long way, but new revenue may be necessary to bring the U.S. closer to a competitive international rate.

Seeing an opportunity, the private sector appears ready to consider trading one form of taxation for another.  Last week, ExxonMobil publicly endorsed a revenue-neutral carbon tax, and AEI cohosted an event with IMF, RFF, and the Brookings Institution to analyze the economics of carbon taxes.  Questions over whether such a policy would violate Grover Norquist's tax pledge forced him into the dialogue, too.

The economics and the timing seem to favor a reasonable discussion over the carbon tax, but is agreement politically feasible?

Though the left has claimed the mantle of action on climate change, they seem dedicated to subsidizing favored industries and technology solutions, rather than simply reducing carbon emissions.  (A common point of opposition to a carbon tax is that it would provide incentives for the use of clean natural gas above renewable power solutions.)  On the right, there is a stern opposition to accepting climate change as a meaningful policy issue and a deep mistrust in creating a new mode of taxation; despite the conservative economics of carbon pricing, few conservative politicians buy in.

But for these purposes, let's assume it is politically possible.  There are still major issues to tackle.  Would a price on carbon be possible without total preemption of EPA authority to regulate the output of carbon dioxide?  Could we construct an appropriate border adjustment that requires foreign trade partners to compete on the same terms?  What kinds of protections for low income individuals will be necessary or possible?

The U.S. can't solve the problem of climate change on its own, and we certainly shouldn't try.  But erecting an appropriate market signal for the economic damage wrought by climate change can help our market adapt, innovate, and, in the right circumstances, grow.  Indeed, if political will dictates action on climate change, a carbon tax is a much more elegant and efficient solution than the clumsy regulatory approach the administration is pursuing now.

*This piece originally appeared on the National Journal Expert Blog.*