

Holy Grail

Are Green Taxes the Answer to Pollution?

By G. Tracy Mehan III

OVER thirty years ago, as a callow youth running the Missouri Department of Natural Resources, I wrote an op-ed for the *St. Louis Post-Dispatch* calling for the substitution of revenue-neutral pollution fees for existing taxes on income and productivity — which I believed made sense environmentally, economically, and politically.

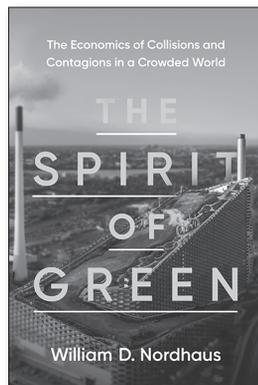
Quoting from the likes of TEF contributor Robert Stavins, Peter Drucker, Jack Kemp, and Lester Brown in *State of the World 1991*, I reasoned that revenue-neutral fees would “internalize the externalities,” imposing costs on the party that generated the pollution, and could be offset by reductions in corporate or marginal tax rates and Social Security taxes. I did not use the term at the time, but they would generate a supply-side economic boost.

“Using these levies on pollution as a substitute for existing, counterproductive taxes on productivity, environmental costs can be incorporated into how America does business to forge a new environmental policy for the next century.” It seemed a surefire way to find common ground between the left and right sides of the political spectrum. It constituted a “no regrets” approach to dealing with a low probability but potentially catastrophic challenge regarding which I was unqualified to assess.

The “next century” is here, but the idea has not caught on, although the *New York Times* reports that Senate Democrats are now looking at a carbon tax in a desperate quest for revenues for their massive \$3.5 to \$5 trillion budget. This is not exactly what I had in mind.

Their plan includes rebates to mitigate regressive impacts for lower-income citizens, but there is no supply-side kick from reducing marginal tax rates, capital gains, etc. Quite the opposite in fact. Revenue-neutrality was the key to my proposed political compromise, but that seems out of the question. More on this subject below.

Given my youthful flirtation with pollution fees, I was pleased to take up Nobel Prize-winning economist William D. Nordhaus’s new book, *The Spirit of Green: The Economics of Col-*



The Spirit of Green: The Economics of Collisions and Contagions in a Crowded World, By William D. Nordhaus; Princeton University Press; \$29.95.

The New Map: Energy, Climate, and the Clash of Nations, By Daniel Yergin; Penguin Press; \$38.00.

lisions and Contagions in a Crowded World, a very useful introduction to and argument for market-based approaches, with an emphasis on “Green Taxes,” which he deems “the holy grail of public policy.” Moreover, “They are the holy trinity of environmental policy: they pay for valuable public services, they meet our environmental objectives efficiently, and they are nondistortionary” — assuming they are grounded in solid cost-benefit analysis. That first part of the trinity would indicate his lack of enthusiasm for the revenue-neutrality element I held near and dear decades ago.

Nordhaus, a Yale professor, surveys

the basic concepts pertaining to externalities (positive and negative), market efficiency and failure, public and private goods, cost-benefit analysis, and the English economist Arthur Pigou, from whom the “analytical thinking behind the Green movement originated.” The chapters are solid and useful for anyone unfamiliar with environmental economics — and often stimulating and informative even if you are not a stranger to the subject matter.

Nordhaus also pursues newer ideas, such as green national accounting, sustainability, ESG (environmental, social, and corporate governance), socially responsible investments, and the social cost of carbon. On this latter point, he seems to see a price of \$40 or \$50+ per ton as just the start of the bidding. This is the range established by the Obama and Biden administrations. He thinks

there is justification, nay, necessity for as much as \$200 per ton to effectively address the challenge of climate change, which he believes is “a major threat to humans and the natural world” and “the ultimate challenge for Green policies.”

“Global warming is one of the defining issues of our time,” writes Nordhaus. Indeed, mitigating climate change or reducing carbon emissions will cost in the range of 2 to 6 percent of world income or “roughly, \$2 trillion to \$6 trillion annually at today’s level of income.”

Regarding the Green New Deal, Nordhaus wants to be supportive of Representative Alexandria Ocasio-Cortez (D-NY) and Senator Edward Markey (D-MA), the prime movers, but he notes its failure to “include any discussion of using market approaches such as prices, taxes, or tradeable permits as instruments of environmental policy.” He argues that “the inconvenient truth” of climate policies “require aggressive price-raising measures, probably through carbon taxes.”

Professor Nordhaus concedes that

In the Literature

green taxes are not common, although congestion pricing in Europe has been successful. But even putting carbon taxes in place will not solve the problem without an international enforcement mechanism, given the global nature of the problem. Of course, the undoing of the Kyoto and Paris agreements on climate has been the free-rider problem which, get ready for it, game theory calls “a noncooperative free-riding equilibrium,” and that’s not good. He recommends something nearly as ambitious as a steep carbon tax: an international club or compact of nations which imposes tariffs on free-riding or non-complying nations which do not put on equivalent green or carbon taxes. This, too, is being discussed by Senate Democrats.

Nordhaus is a towering intellect, but he has strong views and is not shy about expressing them. He hates Trump, despises the Republican Party, abhors Koch Industries, and detests Facebook. That said, he provides a respectful discussion of his agreements and disagreements with his fellow Nobel, libertarian economist Milton Friedman, and points to several conservative economists who support carbon taxes as the most efficient approach to coping with a changing climate. This is true, to a point; but he fails to mention that several of them would look for cuts in other taxes to compensate for the carbon taxes. For instance, Arthur Laffer of the eponymous “Laffer Curve” wrote a famous letter to the editor to the *New York Times* clarifying his support for a carbon tax.

“I am an economist, not a climate scientist, and in my professional capacity I don’t have the slightest idea whether global warming exists or not, or whether mankind has caused it or not. What I do think is true is that a carbon tax offset dollar for dollar with an income tax rate cut would be a positive component of tax reform,” wrote Laffer. “I oppose any carbon tax at any time if it’s not fully offset by a cut in marginal tax rates.”

Considering the magnitude of the carbon taxes required to achieve any-

thing substantive by way of mitigating greenhouse gases, and the failure of the Clinton administration in the early 1990s to pass a BTU tax, a rough, imperfect surrogate for a carbon tax not discussed by Nordhaus, it would seem that political reality, if not sound economics, would justify another look at revenue-neutrality by Green economists.

GIVEN the global nature of the climate issue, readers may want to consult Pulitzer Prize winner Daniel Yergin’s latest tome, *The New Map: Energy, Climate, and the Clash of Nations*, a sequel to his magisterial volume *The Quest*, which I reviewed for the *Forum* nine years ago. Climate is just one part of the geopolitics of energy but is even more pressing since Yergin wrote his previous book.

“Climate’ will be a profound determinant of the new map of energy,” maintains Yergin. And “the momentum of climate policies — powered by research and observation, by climate models, and by political mobilization and regulatory power, social activism, financial institutions, and deepening anxiety — will transform the energy system.”

“Net zero carbon” will be the great challenge of the decades ahead, “not just politically but also in how people live their lives and the costs of achieving it.” Today, the world depends on oil, natural gas, and coal for over 80 percent of its energy, “just as it did thirty years ago.” But the shift to a more pluralistic mix of energy sources is underway and will continue over the decades ahead while “disagreement rages, both within countries and among them, on the nature of the transition: how it unfolds, how long it takes and who pays.”

The myth of “peak oil” has now been replaced by the question of “peak demand” for oil and gas. When might we witness such a thing. “The actual answer,” writes Yergin, “will be deter-

mined by a concatenation of many forces — from what national governments and cities do in terms of regulation and incentives, to economic growth, to the availability of minerals, to the legal liability around autonomous vehicles and the security of the cyber systems controlling them, to the values and lifestyles of millennials, to social media, to the increase in air travel and petrochemicals, to geopolitical conflicts and social instability, to start-ups that have not yet started and new scientific and engineering breakthroughs, and so on.”

There is also the issue of “intermittency” as a challenge to continued expansion of solar and wind and the stability of the grid. “They can flood the grid with electricity when the sun shines and the wind blows, but then almost disappear when the day is cloudy or there is only a murmuring breeze,” notes Yergin. New technologies will be key (another reason Nordhaus argues for internalizing the externalities with a carbon tax), especially storage and battery technology, a stumbling block for wind and solar, as well as advanced reactors and a new

generation of small reactors that might jumpstart carbon-free nuclear power.

And what of consumers? “In the absence of a carbon tax or significant incen-

tives or higher gasoline taxes, how many consumers will willingly pay more for greener energy . . . Some will, some won’t,” says Yergin.

Economics must, inevitably, for good or ill, give way to politics, and the politics of climate will preoccupy us for a long time to come. Contingency, not certainty, will be the norm.

G. Tracy Mehan III is executive director for government affairs with the American Water Works Association and an adjunct professor at Scalia Law School, George Mason University. He may be contacted at tmehan@awwa.org.

For the future of energy, contingency, not certainty, will be the norm