Why We Support a Revenue-Neutral Carbon Tax

By George Shultz & Gary Becker (Hoover Institute Fellows), via Wall Street Journal | April 7, 2013

Americans like to compete on a level playing field. All the players should have an equal opportunity to win based on their competitive merits, not on some artificial imbalance that gives someone or some group a special advantage.

We think this idea should be applied to energy producers. They all should bear the full costs of the use of the energy they provide. Most of these costs are included in what it takes to produce the energy in the first place, but they vary greatly in the price imposed on society by the pollution they emit and its impact on human health and well-being, the air we breathe and the climate we create. We should identify these costs and see that they are attributed to the form of energy that causes them.

At the same time, we should seek out the many forms of subsidy that run through the entire energy enterprise and eliminate them. In their place we propose a measure that could go a long way toward leveling the playing field: a revenue-neutral tax on carbon, a major pollutant. A carbon tax would encourage producers and consumers to shift toward energy sources that emit less carbon—such as toward gas-fired power plants and away from coal-fired plants—and generate greater demand for electric and flex-fuel cars and lesser demand for conventional gasoline-powered cars.

We argue for revenue neutrality on the grounds that this tax should be exclusively for the purpose of leveling the playing field, not for financing some other government programs or for expanding the government sector. And revenue neutrality means that it will not have fiscal drag on economic growth.

The imposition of such a tax raises questions about how it should be levied and what measures should be used to see that the revenues collected are refunded to the public so that the tax is clearly revenue-neutral.

The tax might be imposed at a variety of stages in the production and distribution of energy. You can make an argument for imposing it at the point most visible to the population at large, which would be the point of consumption such as gasoline stations and electricity bills. An administratively more efficient way of imposing the tax, however, would be to collect it at the level of production, which would reduce greatly the number of collection points.

Revenue neutrality comes from distribution of the proceeds, which could be done in many ways. On the grounds of ease of administration and visibility, we advocate having the tax collected and distributed by an existing unit of government, either the Internal Revenue Service or the Social Security Administration. In either case, we think the principle of transparency should be observed. Funds collected should go into an identified fund and the amounts flowing in and out should be clearly visible. This flow of funds should not be included in the unified budget, so as to keep the money from being spent on general government purposes, as happened to the earlier excess of inflows over outflows in the Social Security system.

In the case of administration by the IRS, an annual distribution could be made to every taxpayer and recipient of the Earned Income Tax Credit. In the case of the SSA, the distribution could be made, in terms proportionate to the dollars involved, to everyone either paying into the system or receiving benefits from it. In any case, checks to recipients should be identified as "Your carbon dividend."

The right level of the tax for the United States deserves careful study, but the principle of a lower starting rate with scheduled increases to an identified level has proven to be a good one in the five-year experience of a similar carbon tax in British Columbia. This gives time for producers and consumers to get accustomed to a carbon tax, and to discover how they can respond efficiently.

The tax should also further increase over time if the apparent severity of the climate effects is growing and, alternatively, the tax should fall over time if the severity appears to be decreasing. Finally, to equalize the present and future burdens, the carbon tax rate should rise over time approximately at the real interest rate (say, the real return on 10-year Treasurys), so that the present value of the burden would be the same to future consumers and producers as it is to present ones.

A revenue-neutral carbon tax should be supplemented by a reasonable and sustained support for research and development in the energy area. However, we would eliminate any program (loan guarantees, etc.) that tempts the government to get into commercial activities. Clearly, a revenue-neutral carbon tax would benefit all Americans by eliminating the need for costly energy subsidies while promoting a level playing field for energy producers.

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