

# POLICY BRIEF

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## **Citizens' Guide to Initiative 732: to increase carbon-based energy taxes and reduce the state sales tax and business taxes to reduce carbon emissions**

By Todd Myers  
Director, Center for the Environment

October 2016

### **Key findings**

- Initiative 732 would increase taxes on carbon-based energy while cutting sales and business taxes to provide an incentive to reduce Washington's carbon emissions without raising the general tax burden.
- The initiative would raise taxes by about 15 cents per gallon of gas initially, up to 25 cents per gallon, then gradually increasing after that.
- To offset that increase, it would cut state sales taxes from 6.5 percent to six percent in 2017 and then to 5.5 percent in 2018.
- The Washington State Office of Financial Management says the initiative would result in a \$200 million average annual tax cut statewide.
- Families and businesses would see varying impacts based on the mix of energy costs and sales tax they currently pay.
- For example, farms with low fuel costs and high capital expenditure would expect to see their taxes reduced. Farms with larger fuel costs or low capital expenditure would likely see their tax bills increase.



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# Citizens' Guide to Initiative 732: to increase carbon-based energy taxes and reduce the state sales tax and business taxes to reduce carbon emissions

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With climate change ranking as the most divisive issue in national politics,<sup>1</sup> it is not surprising that Initiative 732, which seeks to cut carbon emissions, is contentious. It is the most recent in a series of policies designed to address climate change. For example, in 2015, Governor Inslee's proposal to create a cap-and-trade system for Washington state failed to make it to the floor of the legislature due to bipartisan opposition.<sup>2</sup> After that failure, he ordered the Department of Ecology to implement a new rule, circumventing legislative approval, to create a similar system of carbon caps.

The revenue-neutral carbon tax proposed by Initiative 732, however, has shifted some of the traditional political lines in Washington, with the left and right finding splits in support and in opposition.

At the center of this conflict is a change from the traditional approach to climate policy. For more than a decade, Washington's climate policy has been defined by a combination of mandates – like requirements to generate “renewable” energy<sup>3</sup> or blend biofuels in gasoline – and subsidies, such as tax breaks for solar energy and electric vehicles. Politicians and government chose the technologies and beneficiaries of taxpayer funds, and then impose their favored policy on the public.

The revenue-neutral carbon tax initiative proposes a very different approach. It would apply a tax to carbon-based energy, both electricity and motor fuel, and would cut other taxes to offset the new tax increase. Rather than increasing revenue or funding more government programs, the goal is to shift the incentives of companies and families away from carbon-based energy.

This change has caused a rift among those on both left and right. Some Republican lawmakers have endorsed Initiative 732, including State Senators Mark Miloscia and Joe Fain,<sup>4</sup> while the state's chamber of commerce, the Association of

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1 “Poll: Climate is most divisive issue in U.S.,” by Timothy Cama, *The Hill*, June 7, 2016, at <http://thehill.com/policy/energy-environment/282554-poll-climate-is-most-divisive-issue-in-us>, accessed October 3, 2016.

2 “SB 5283 - Implementing a carbon pollution market program to reduce greenhouse gas emissions,” Washington State Legislature, at <http://app.leg.wa.gov/billinfo/summary.aspx?bill=5283&year=2015>, accessed October 10, 2016.

3 “Text of Initiative 937,” Washington Secretary of State, at <https://www.sos.wa.gov/elections/initiatives/text/i937.pdf>, accessed October 10, 2016.

4 Yes on 732, “Endorsements,” at <https://yeson732.org/endorsements/>, accessed October 10, 2016.

Washington Business, has been the most vocal critic of the initiative.

Additionally, the environmental community is split over the initiative. Two dramatic examples stand out. First, when CarbonWA, the organization proposing Initiative 732, announced it had collected enough signatures to file the initiative, major environmental donors made a huge financial offer to CarbonWA to throw the signatures away and create an alternative initiative in keeping with the environmental community's traditional, government-centric approach. When CarbonWA refused, groups like the Washington Environmental Council announced they would oppose the initiative.<sup>5</sup>

That decision has caused internal dissention among some in the community. The Sierra Club, for example, voted not to support Initiative 732. Rank-and-file members, however, asked to reconsider that position. Instead, staff from the Sierra Club's national office overruled the local request, forcing the Washington state chapter to oppose the initiative.<sup>6</sup>

Polls, show the voters are confused and undecided about Initiative 732's revenue-neutral approach, showing large numbers of undecided voters.<sup>7</sup>

In this Citizens Guide we will review the details of the initiative and how it would impact families, state revenues and state business. As with any tax reform, there would be winners and losers. Some outcomes are not surprising. There are, however, some surprising beneficiaries from the initiative. Overall, the state's budget agency, the Office of Financial Management (OFM), estimates Initiative 732 would amount to a tax cut averaging about \$228 million a year for the first six years, which means there would be many people who would see their taxes reduced as a result of the initiative.<sup>8</sup>

Finally, as the split in political support demonstrates, Initiative 732 represents an interesting change in standard environmental policy. Even for those who decide to oppose Initiative 732 based on the specifics of the proposal, it is an approach that moves decision making and responsibility about environmental policy away from politicians and puts it in the hands of individuals most able to make effective change. As such, it represents an effective environmental approach that should be considered more frequently.

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5 "CarbonWA on the fence," CarbonWA, December 23, 2015, at <http://yeson732.org/carbonwa-on-the-fence/>, October 10, 2016.

6 "What is going on? Why the Big Rift over I-732 Among Environmental Groups?" by Court Olson, Daily Kos, September 30, 2016, at <http://www.dailykos.com/story/2016/9/30/1576484/-What-is-going-on-Why-the-Big-Rift-Over-I-732-Among-Environmental-Groups>, accessed October 10, 2016.

7 "Elway poll: Voters split on November initiatives," by Jim Camden, *The Spokesman-Review*, August 18, 2016, at <http://www.spokesman.com/blogs/spincontrol/2016/aug/18/elway-poll-voters-split-november-intiatives/>, accessed October 10, 2016.

8 Washington State Office of Financial Management, "Fiscal Impact Statement for Initiative 732," Washington State Office of Financial Management, at <http://www.ofm.wa.gov/ballot/2016/Initiative732FIS.pdf>, accessed October 10, 2016.

## Initiative 732

There are four major parts to the initiative, designed to “establish Washington state’s national leadership in addressing both climate change and the acidification of the oceans.”<sup>9</sup> To achieve that goal, initiative authors recognize that tax increases would harm the economy, noting, “reduction of Washington state’s high sales tax will increase commerce in this state; reduction of the business and occupation tax on manufacturers will encourage business formation and expansion by reducing the burden of this tax.”<sup>10</sup> As a result, the initiative increases taxes on carbon-based energy while cutting sales and business taxes.

Initiative 732 would make four changes to Washington’s tax structure.

First, it would impose a tax on carbon-based energy. The tax would begin at \$15 per metric ton (MT) of CO<sub>2</sub> in 2017. It would move up to \$25 per MT of CO<sub>2</sub> in 2018 and would increase by 3.5 percent plus inflation after that. The price of carbon emissions would not increase above \$100 per MT in 2016 dollars, a level it is estimated would be reached in about 2060.<sup>11</sup>

Those numbers translate into increases in taxes on gasoline and energy. For electricity, an increase in \$10 for a ton of CO<sub>2</sub> results in an increase of about one cent per kilowatt hour (kWh) for coal-generated electricity and about one-half cent per kWh for natural gas.

Washington state currently has some of the lowest retail rates for electricity in the country, averaging 7.1 cents per kWh.<sup>12</sup> When the tax reaches \$30 per ton of CO<sub>2</sub> several years from now, this would increase average costs by about 0.6 cents per kWh statewide, keeping us well below the national average of 10.4 cents per kWh. There are differences across Washington, however. In much of Eastern Washington, where hydro power is dominant, the increase would be lower. For utilities that rely on coal or natural gas, the increase would be higher.

Estimating the impact on gas prices is much more straightforward. A one-dollar increase in the price of CO<sub>2</sub> translates into an increase of about one cent per gallon price increase. In 2017, this would amount to an increase of about 15 cents per gallon, up to 25 cents per gallon in 2018 and gradually increasing after that.

There are some exemptions to these increases. Most notably, the tax on agricultural fuel would be phased in, beginning at five percent of the rate in 2017, moving

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9 Washington Secretary of State, Initiative 732.

10 Ibid.

11 “Economic Impact Analysis: Washington’s Initiative 732,” Energy Strategies, LLC, September 12, 2016, at <https://static1.squarespace.com/static/578c4ff7e6f2e1b4d3cb3a09/t/57dc7a9120099eab7d6b24c8/1474067091465/Washington+Initiative+732+Analysis.pdf> accessed October 10, 2016.

12 “Washington Electricity Profile 2014,” U.S. Energy Information Administration, March 24, 2016, at <http://www.eia.gov/electricity/state/washington/>, accessed October 10, 2016.

up to 10 percent in 2019 and then increasing by five percent per biennium until the rate is 100 percent in 2055.<sup>13</sup>

To offset those increases, Initiative 732 would cut taxes in three areas.

First, it would cut the state sales tax from 6.5 percent to six percent in 2017. It would then cut the tax another half percent, down to 5.5 percent in 2018.

Second, it would cut business taxes on manufacturing from 0.484 percent down to 0.001 percent. It would cut business taxes to 0.001 percent for a number of other energy-intensive industries, including semiconductor manufacturing, food processing, dairy products, seafood and seafood products, meat processing, aircraft production and other impacted industries. Taxes would be cut for these industries due to concern that sales tax cuts would not offset the increased energy costs. Without those business tax cuts, the result could be that energy-intensive industries move out of Washington, harming the economy and simply moving carbon emissions elsewhere in the world.

The last element of Initiative 732 is the “Working Families Tax Rebate.” Similar to the Earned Income Tax Credit (EITC) at the federal level, the Working Families Tax Rebate was adopted in 2008 but has never been funded. The goal is to provide a tax credit to low-income workers who qualify for the federal EITC. This would amount to 25 percent of the amount claimed by an individual on their federal tax return or \$100, whichever is greater.

The goal of the tax credit generally is to provide an incentive to work, reducing the impact of lost welfare benefits as well as reducing the impact of the increased energy taxes on low-income families.

That mix of energy tax increases and tax cuts are intended to be revenue-neutral. The impact on individual families and businesses, however, would depend on a number of variables. Some people would see their taxes cut. Others would see an increase.

## **Impacts on families, businesses and state government**

As with any projection, the results are speculative and there have been a range of estimates regarding the financial impact of Initiative 732.

The most often cited estimate comes from OFM, which projects that in the first four years, Initiative 732 would cut taxes by about \$797.2 million. Advocates for Initiative 732 argue this is inaccurate, saying OFM did not accurately account for electricity that is exported, which is taxed, and a number of other adjustments.<sup>14</sup> Estimates for these adjustments, they argue, make the policy revenue-neutral.

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<sup>13</sup> Washington Secretary of State, Initiative 732.

<sup>14</sup> “Comments on the Office of Financial Management’s Fiscal Note on I-732,” Yes on 732 campaign, January 28, 2016, at <http://yeson732.org/wp-content/uploads/2016/01/OFM.0.160128.AllDocumentsPackage.pdf>, accessed October 10, 2016.

Opponents, however, have focused on OFM's projection. The projection that Initiative 732 would result in a tax cut has raised concerns because the state Supreme Court is attempting to increase spending on education, and a tax cut from Initiative 732 would make it difficult to meet the Court's requirement.

For example, the "No on 732" campaign, organized by the Association of Washington Business, notes that Initiative 732, "cuts \$800 million from the state budget, putting funding at risk for education, healthcare, and public safety."<sup>15</sup> In its statement about Initiative 732, the Sierra Club makes a similar argument, saying, "At a time when our state needs additional revenue to fund education, parks, environmental programs, and social services, we are concerned about any projected revenue cuts."<sup>16</sup>

One irony of the Sierra Club's position is that while it opposes the tax cut, worrying that it would reduce funding for education, it supports subsidies for ineffective environmental policies, such as solar power,<sup>17</sup> and for light rail.<sup>18</sup> The funding for those wasteful efforts reduces the pool of funding for education and other programs, or reduces the potential tax base for such programs. Additionally, these are extremely ineffective approaches to cutting emissions. In that light, the Sierra Club's complaints about cutting taxes are hypocritical.

Despite analysis showing that the initiative would result in an overall tax cut, how the taxes play out for individual families will vary. The University of Washington created an online tool to estimate the cost for both families and businesses.<sup>19</sup> The results vary depending on a variety of factors.

For example, a married couple in Bellevue with two children with a household income of \$75,000 per year would save an average of \$95 per year in total taxes. The family would pay \$174 more in energy costs, but would save \$269 from the sales tax reduction.

A couple in Moses Lake with two children, earning \$45,000 a year, on the other hand, using 20 gallons of gasoline a week, would pay about \$181 more per year. If that family qualified for the Earned Income Tax Credit, however, they would save \$40 per year.<sup>20</sup>

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15 "Why No on 732," No on 732 campaign, at <http://www.noon732.com/about/>, accessed October 3, 2016.

16 "Sierra Club Position on Carbon Washington Ballot Initiative 732," The Sierra Club, at <http://sierraclub.org/washington/sierra-club-position-carbon-washington-ballot-initiative-732>, accessed October 10, 2016.

17 "Learn about solar," The Sierra Club, at <http://content.sierraclub.org/solar/learn-about-solar>, accessed October 10, 2016.

18 Letter to Sound Transit, by Tim Gould, January 28, 2016, at <https://www.sierraclub.org/sites/www.sierraclub.org/files/sce/washington-state-chapter/Conservation/Transportation/ST3%20comment%20Ltr.pdf>, accessed October 10, 2016.

19 "Carbon Tax Swap Calculator," University of Washington, at <http://carbon.cs.washington.edu/>, accessed October 10, 2016.

20 Individuals can calculate the impact for their own family using the calculator at <http://carbon.cs.washington.edu>.

The Association of Washington Business (AWB), however, has its own model, which indicates the cost would be higher for families. They find that, “increase of electricity, natural gas, and gasoline prices is estimated to increase a typical Washington household’s expenditures on energy by more than \$37 per month.”<sup>21</sup>

The AWB model argues Initiative 732 would increase the average cost per kWh in Washington by about 0.5 cents per kWh. That estimate seems credible. According to the Energy Information Administration, only 15 percent of Washington’s electricity generation comes from coal or natural gas. This does not include electricity imported from outside the state, which adds several percentage points. Based on those numbers, economist Dallas Burtraw estimates, “the average change in electricity generation costs from a \$30 carbon tax would be 0.58 cents per kWh,” for an increase of about 6.4 percent.<sup>22</sup>

Using existing numbers, the math is fairly straightforward. If half of Washington’s carbon-based energy is natural gas and half is coal, the increase for that portion of the electricity would be about 2.25 cents. Since that increase applies only to 25 percent of Washington’s energy, the increase would be 0.56 cents per kWh, similar to Burtraw’s estimate.

Finally, there are estimates on how much Initiative 732 would impact businesses in Washington state. As noted above, in addition to cutting sales taxes, the initiative would also cut a number of businesses taxes in an effort to reduce or eliminate the tax impact, especially for those industries hit hardest by the energy tax. There are two primary concerns.

First, as shown by the idling of the Alcoa aluminum plants in Washington state last year, due to international competition and high costs in Washington state,<sup>23</sup> companies that face international competition and rising cost could shut down or move, killing jobs and harming Washington’s economy.

Second, when production moves out of Washington state to another country, it does not reduce the amount of carbon emitted worldwide. Production-related carbon simply shifts elsewhere in the world and, potentially, to plants that are less efficient and more energy intensive.

Making the tax neutral for businesses, therefore, is an important part of the equation. Indeed, the Yes on 732 campaign notes, “Energy-intensive businesses like

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21 “Economic Impact Analysis: Washington’s Initiative 732,” Association of Washington Business, September 12, 2016, [https://static1.squarespace.com/static/578c4ff7e6f2e1b4d3cb3a09/t/57fd10ac440243cf0126ad5b/1476202670329/Washington+Initiative+732\\_Economic+Analysis\\_Oct\\_10\\_2016\\_Final.pdf](https://static1.squarespace.com/static/578c4ff7e6f2e1b4d3cb3a09/t/57fd10ac440243cf0126ad5b/1476202670329/Washington+Initiative+732_Economic+Analysis_Oct_10_2016_Final.pdf), accessed October 17, 2016.

22 “Washington State’s Initiative 732: Impact on Electricity Prices Should be Small,” by Dallas Burtraw, Resources for the Future, September 21, 2016, at <http://www.rff.org/blog/2016/washington-state-s-initiative-732-impact-electricity-prices-should-be-small>, accessed October 7, 2016.

23 “Alcoa idling two smelters in Washington state,” by staff, *The Seattle Times*, November 2, at 2015, <http://www.seattletimes.com/business/economy/alcoa-closing-two-smelters-in-washington-state/>.

manufacturers will pay considerably more in carbon taxes, but effectively eliminating the B&O business tax for manufacturers will help to offset those impacts.”<sup>24</sup>

The University of Washington has a calculator for businesses as well, helping business owners estimate the impact of the initiative by entering their sales taxes, manufacturing B&O taxes, gas and diesel usage, air travel and facility energy use.<sup>25</sup>

The Association of Washington Business applied its estimates to Washington state and projected it would reduce Washington’s total Gross State Product (GSP) by about one percent in 2040. Additionally, AWB estimates the impact on jobs and finds mixed results. They note:

“Overall the model shows the net difference in employment between the business as usual scenario and the I-732 scenario is negligible by 2040, at a gain of 4,777 jobs or 0.12%. However, over the same time period, there is a loss of 22,690 private sector jobs, and a gain of 27,468 jobs in the government and miscellaneous sector.”<sup>26</sup>

The modeling for these estimates have not been released, so it is difficult to measure the accuracy of these estimates.

One sector that stands out is agriculture. Farmers are protected from a number of state taxes and Initiative 732 phases in taxes that would impact farmers, including taxes on diesel. The initiative notes that taxes on, “diesel fuels, biodiesel fuel, or aircraft fuel used solely for agricultural purposes,” would be phased in, beginning with five percent of the rate in 2017, ten percent of the rate in 2019 and then increasing five percent per biennium until it reaches 100 percent in 2055.<sup>27</sup> This helps mitigate the impact, but the results will vary from farm to farm.

Washington State University modeled the impact of Initiative 732 on agriculture and forestry during the first two, phase-in, years of the initiative.<sup>28</sup> Researchers found that in the early years, the cut in sales taxes slightly outweighed the fuel taxes, leading to an increase in output of 1.76 percent for agriculture and 0.11 percent for forestry. They see a slight increase in agricultural exports of 1.44 percent but a decline of forestry exports of 0.05 percent.<sup>29</sup>

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24 “All About Initiative 732,” Yes on 732 campaign, at <https://yeson732.org/faq/>, accessed October 8, 2016.

25 University of Washington, “Carbon Tax Swap Calculator: Business Calculator,” 2016, at <http://carbon.cs.washington.edu/business.html>.

26 “Economic Impact Analysis: Washington’s Initiative 732,” Association of Washington Business, September 12, 2016, page 7, at [https://static1.squarespace.com/static/578c4ff7e6f2e1b4d3cb3a09/t/57fd10ac440243cf0126ad5b/1476202670329/Washington+Initiative+732\\_Economic+Analysis\\_Oct\\_10\\_2016\\_Final.pdf](https://static1.squarespace.com/static/578c4ff7e6f2e1b4d3cb3a09/t/57fd10ac440243cf0126ad5b/1476202670329/Washington+Initiative+732_Economic+Analysis_Oct_10_2016_Final.pdf), accessed October 17, 2016.

27 Secretary of State, Initiative 732.

28 “How does Washington State initiative 732 impact the agriculture and forestry sectors?” by Gregory Galinato, Timothy Nadreau and Tristan Skolud, Washington State University, April 15, 2016, at <http://ses.wsu.edu/wp-content/uploads/2016/04/WP2016-8.pdf>, accessed October 9, 2016.

29 Ibid.

With such a small total impact, the farm-by-farm effects would certainly be different. We asked three Eastern Washington farmers for data regarding their fuel expenditures, capital purchases, sales tax expenses and electricity purchases.<sup>30</sup> The three farms represent three different levels of expenditure.

The two smaller farms would see their total tax bill go down in the first two years, primarily because their capital purchases and purchases subject to sales tax overshadowed the additional fuel cost. The largest farm, however, saw an increase in costs due to high fuel consumption and relatively low capital costs. For the same reason, the savings for the two smaller farms actually increased in the second year and the cost increased for the larger farm as the sales tax cut and fuel tax increase were both phased in.

This is not to say these three farms are representative of most farms around the state, but as a case study they demonstrate that individual farms would fare differently depending on the ratio of capital expenditure and purchases subject to sales tax versus fuel expenditures.

Finally, the businesses that appear most likely to come out on the short end of Initiative 732 are energy-intensive, trade-exposed industries like concrete production, aluminum smelters and pulp and paper mills. These companies have been reluctant, for obvious reasons, to release detailed financial information about the impact of Initiative 732 on their business. However, they have stated publicly that the increase in energy costs would have a net negative impact on them. Indeed, four of the top five contributors to the “No on 732” campaign are Kaiser Aluminum, Ash Grove Cement Company, Inc., Northwest Pulp and Paper Association and Nucor Steel Seattle, Inc. This opposition indicates that their internal accounting demonstrates the initiative would be a significant cost to their businesses.

As with any tax reform, the impacts vary. The impacts of Initiative 732 would vary not only due to the structure of the initiative itself, but due to the existing tax structure in our state. Business owners, having adjusted to the current set of costs and incentives, would see those incentives change. In some cases, that would be financially positive and in others, negative.

## **Carbon reductions**

Finally, the purpose of the initiative is to cut carbon emissions and reduce risks from climate change. A similar policy was implemented in British Columbia in 2008, with the price of carbon reaching \$30 per ton. As a result, carbon emissions fell by about 13 percent per capita during the six years after implementation, compared to about 3.7 percent during the eight years’ prior.<sup>31</sup> These numbers exclude electricity,

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30 As part of receiving this sensitive information, we promised not to disclose the details, so what is represented here is a summary of the results.

31 “British Columbia’s Carbon Tax: By the Numbers,” by Charles Komanoff, Carbontax.org, December 17, 2015, <http://www.carbontax.org/blog/2015/12/17/british-columbias-carbon-tax-by-the-numbers/>, accessed October 9, 2016.

since British Columbia, much like Washington state, has a high percentage of clean hydro power.

Opponents of Initiative 732 note that Washington has one of the lowest levels of carbon emissions in the country. According to the Energy Information Administration, Washington ranks 10th in per capita energy-related carbon emissions, with only 63 percent of the average emission across the country.<sup>32</sup>

The significance of the carbon reduction under Initiative 732 would depend on how significant one feels the risk from climate change is.

## Conclusion

Ultimately, people will have to judge the costs and benefits of the policy individually. For those concerned about climate change, Initiative 732 yields more carbon reduction, at lower cost, than any of the alternative policies offered at the state or local level. A survey of 41 prominent economists asked if a “tax on the carbon content of fuels would be a less expensive way to reduce carbon-dioxide emissions that would a collection of policies such as ‘corporate average fuel economy’ requirements for automobiles.” Ninety percent of panelists agreed.<sup>33</sup> This approach is significantly less costly than the government-heavy approach that dominates Washington’s current climate policy.

For those less concerned about climate change, the judgement comes down to weighing the impact of an estimated \$200 million annual tax cut versus the impact on state government spending. Some individuals and businesses would see their tax burden decline; others would see it increase.

As the strong opposition from the environmental community demonstrates, a revenue-neutral approach of taxing carbon emissions is very far from the top-down, government-heavy approach that has come to define so much of our environmental policy. Rather than a politically driven mix of subsidies for favored industries, increased regulation and expanded government spending, putting a price on carbon emission and cutting other taxes provides consumers the incentive to use the information that only they have to make small adjustments to reduce their environmental impact. And, the more effective people are at finding ways to reduce emissions, the greater the tax cut they would personally receive.

Whether that calculus applies to carbon emissions and whether Initiative 732 delivers on that model, people can decide for themselves. However, if this begins a discussion about moving away from top-down environmental policy, it will have served a positive purpose.

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32 “Per capita energy-related carbon dioxide emissions by State (2000-2013),” U.S. Energy Information Administration, October 26, 2015, at <http://www.eia.gov/environment/emissions/state/analysis/>.

33 “Carbon Tax,” IGM Forum, December 20, 2011, at [http://www.igmchicago.org/igm-economic-experts-panel/poll-results?SurveyID=SV\\_9Rezb430SESUA4Y](http://www.igmchicago.org/igm-economic-experts-panel/poll-results?SurveyID=SV_9Rezb430SESUA4Y), accessed October 10, 2016.

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Washington Policy Center  
PO Box 3643  
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E-mail: [wpc@washingtonpolicy.org](mailto:wpc@washingtonpolicy.org)  
Phone: (206) 937-9691

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### About the Author



**Todd Myers** is the Director of the Center for the Environment at Washington Policy Center. He is one of the nation's leading experts on free-market environmental policy. Todd is the author of the landmark 2011 book *Eco-Fads: How the Rise of Trendy Environmentalism Is Harming the Environment* and is designated a *Wall Street Journal Expert* panelist for energy and the environment. Todd's research on the failure of "green" school mandates has stirred a reassessment of those requirements in school districts across the country. He currently sits on the Puget Sound Salmon Recovery Council and served on the executive team at the Washington State Department of Natural Resources. Todd also served as Director of Public Relations for the Seattle SuperSonics and Director of Public Affairs for the Seattle Mariners, and he holds a Master's degree from the University of Washington. He and his wife live in the foothills of the Cascade Mountains with two dogs and 200,000 honeybees.