

Promoting Personal Choice, Incentives and Investment to Cut Greenhouse Gases

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May 2008

Relying heavily on regulation, government programs and a system of CO₂ emissions caps, the 2008 Legislature passed aggressive legislation designed to address climate change. Before the Governor's Climate Advisory Team had even finished its report, the Legislature had written and designed a system of rules they said would reduce greenhouse gas emissions in Washington while creating new "green collar" jobs.

The plan, however, relies heavily on forcing families to make significant lifestyle changes and subsidizes technologies that many are already questioning.

Governor Gregoire's Climate Advisory Team is quite up front about the scope of government involvement. They even go so far as to say that their report "charts the path to transforming our economy and our lifestyles to reduce Washington's contribution to global warming."¹ The CAT recommendations are built around a "cap-and-trade" system that caps emissions and then allows companies who cannot reach the cap to purchase emissions allowances from those who are under the cap. While a cap-and-trade system is "market-based," the key decisions, where to set the emissions cap and how to account for carbon emissions and

savings, are chosen by politicians. These decisions can make all the difference in how effective and efficient a cap-and-trade system is compared with other approaches.

The problem with such an approach is that it relies on the supposed ability of government officials to make wise decisions about a number of industries, keep up with the rapid pace of economic development, understand the complex exchanges that occur in the economy, and anticipate the unintended consequences of the decisions of millions of people in Washington. Some may have faith in the ability of political decision makers to keep track of all of those things, but history has not been kind to such faith.

There is a truly market-based system that can reduce greenhouse gases by harnessing the creativity of everyone in Washington, creating incentives for technological innovation and providing the flexibility needed to adapt to changing circumstances in the future. By increasing the price of carbon and cutting taxes to offset the price increase, Washington may take a significant step toward reducing CO₂ emissions in a way that is both effective and efficient.

The problems associated with a system that relies on government regulation and lifestyle changes can be overcome with an approach that is more flexible, creates strong incentives to innovate, and aggregates the dispersed information held by millions of Washington

¹ Washington State Climate Advisory Team, "Leading the Way: A Comprehensive Approach to Reducing Greenhouse Gases in Washington State," January 25, 2008, http://www.ecy.wa.gov/climatechange/InterimReport/climate_08-B-CAT.pdf (Accessed February 9, 2008)

residents: a revenue-neutral carbon tax that encourages reductions in emissions while reducing taxes on families and innovators.

This approach contains three elements:

- Place a tax on carbon, including motor and heating fuels, while exempting biofuels.
- Cut sales taxes to offset the increased cost to families of the carbon tax.
- Cut taxes on capital investment to encourage new technologies, the replacement of inefficient equipment, and spur economic growth and job creation.

This approach has a number of advantages.

It gives families choices. A tax on carbon, with reductions in other taxes, puts families in charge of how much they are taxed. Since other taxes are reduced to match the increase in carbon taxes, the impact on the family budget should be near zero. They can, however, reduce their overall taxes. The more ways they find to conserve energy, the lower their taxes on carbon will be. Under the system enacted by the legislature and other local elected officials, lifestyle changes are mandated and regulations increased until families are compelled to comply.

It promotes technology growth. Families and businesses looking to avoid the tax will purchase more efficient technology, creating demand for innovators to fill. Tax reductions on capital investment will make it easier for companies to take those innovations from the drawing board to the market and will make it more cost effective for companies to improve the efficiency of their equipment.

It truly creates jobs. With the legislature's current plan, jobs are not really created – they are simply shifted from one sector of the economy to the “green” sector. Ironically, this may actually have the result of creating lower paying jobs as they are moved from efficient sectors to the less-efficient “green” sector. Tax

cuts on capital investment, however, are widely recognized to be effective at spurring innovation and investment that is the best way to create economic growth bringing not just jobs, but higher paying jobs.

It engages the creativity of millions, not just a few in Olympia. Government strategies that subsidize and promote particular technologies suffer from incomplete information and are often influenced not by science but politics. A broad, but low, tax on carbon encourages every family and business to find ways, large and small, to cut CO2 emissions and energy use. The combined impact of millions of small changes is more likely to be effective and less likely to be motivated by the political preferences of politicians and government agencies.

It is flexible. Not only does a carbon tax give families and businesses more ability to avoid the tax, it is more stable and predictable than a system based on emissions caps. Washington environmental activists are pushing for hard and inflexible emissions caps that would make it difficult to adjust from year to year economic changes and weather. A carbon tax, however, would encourage additional reductions in CO2 emissions in years when it was inexpensive, but allow higher emissions in years when cutting emissions was exceedingly expensive. This flexibility reduces economic distortions and price shocks that can occur with cap-based systems.

There are still many details that need to be worked out to ensure that a carbon tax policy would have the desired impact. This proposal, however—a carbon tax offset by cuts in other taxes—may be the best way to address the risks from greenhouse gas emissions in a responsible manner.

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