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Carbon Taxes:
An Opportunity for Conservatives

By Irwin Stelzer
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It is always troubling when conservatives emulate Yasser Arafat and never miss an opportunity to miss an opportunity. Conservatives have before them a golden opportunity to accomplish several important conservative goals, but are so frightened by words like “tax”, “cap and trade”, “global warming” and the like that they are frozen in opposition to programs they should support.

Forget about the battle over global warming. The earth either is or isn’t warming. If it is, that is either the result of human activity or it isn’t. If it is the result of human activity, either an American initiative will shame China and India into following suit, or it won’t. No matter. The appropriate policy towards carbon emissions has little or nothing to do with those controversies, or at least should not for conservatives. They should focus on multiple opportunities to advance the conservative agenda:

- advance national security interests by reducing dependence on oil imports;
- stem the flow of dollars to the bad guys;
- lower taxes on jobs;
- eliminate the rationale for subsidizing uneconomic energy sources;
- reduce the drive for regulation of the energy economy;
- gain a revenue source that might be needed when the grand bargain over entitlements is struck.

Not a bad list of gains to be had by rethinking conservative positions on carbon taxes.

If the uproar in the Middle East tells us anything it is that dependence of oil from that region of the world is a security threat, now more than ever. Even if you believe the outcome will be the establishment of democratic states eager to trade their oil for the funds needed to eliminate poverty, that belief must be tempered with more than a little doubt. There is a real possibility that control of vital oil supplies in Iraq, Libya and even Saudi Arabia will fall into the hands of unfriendlies who are more interested in doing us harm than their own people good. There is an even greater possibility that China’s insatiable need for oil, combined with the financial resources earned from the distorted trade patterns it is imposing on the world system, and its ability to deal comfortably with anti-American regimes, will tie up an inordinate portion of world supplies, at minimum converting $100 per barrel oil from spikes to a plateau.

We can never, of course, be energy independent, as presidents since Richard Nixon seem unable to understand. But we can be less dependent by doing two things. Ending the self-defeating process of creating barriers to the development of domestic resources, and limiting our consumption of oil. I leave exploration of the first of these alternatives to folks more optimistic than I — the regulatory processes are in the control of a dedicated band of people who trust their ability to know what is best for society, often in the absence of legislation to inform their judgments, and in my view, will never cede effective control of exploration and development.

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Limiting oil consumption, however, is possible — if we do one of two things: ration, or allow the price of oil products to rise. The first creates such distortions as to be unworthy of serious discussion absent a war or similar cataclysm — remember the good old days of odd-and-even license plate numbers? The second is a distinct possibility — if we can get over the fear of the word "tax".

A tax on carbon, whether it takes the form of a levy on emissions, or a second-best substitute, a tax on gasoline, would accomplish a host of conservative goals. First, by reducing oil consumption it would reduce the security threat posed by the increasing possibility that crude oil reserves will fall under the control of those who would do us harm, either by cutting off supplies, as happened when American policy towards Israel displeased the Arab world, or by using the proceeds of their oil sales to fund the spread of radical Islam and attacks by jihadists. No one doubts that the execrable Hugo Chávez survives only because we pay millions for Venezuelan oil, or that Saudi funding of radical Islam is made possible in good part by our payments for the Kingdom's oil. If we curtail our use of oil we reduce our overall imports and, thereby, the flow of funds that end up in hostile hands. Needing less oil, we can concentrate the reduction in our demand on supply sources we consider the greatest danger to our security and/or have the highest externalities associated with their use.

A tax on carbon would make all of that possible. And need not swell the government's coffers — if we pursue a second, long-held conservative objective: reducing the tax on work. It would be a relatively simple matter to arrange a dollar-for-dollar, simultaneous reduction in payroll taxes as taxes on, say, gasoline, increased. Anyone interested in jobs, jobs, jobs should find this an attractive proposition, with growth-minded conservatives leading the applause.

This would, of course, involve a transfer of the tax burden from workers and employers to drivers, and would probably hit non-urbanites a bit harder than their city-dwelling brethren who rely more on public transportation and their feet. But every tax has distributional consequences, as does every tax cut: to use that fact as a reason never to change the tax structure is to perpetuate all of the inanities and inequities of the present system. Besides, it is not impossible to include a tax on heating oil, relied on more in the Northeast, where consumers are likely to drive fewer miles each year than their Western brethren, who rely less on oil to heat their homes. In short, by taxing not only gasoline but heating oil, we accomplish a sort of regional equity, which should eliminate at least one reason that Western-state legislators can reasonably object to a carbon-related tax.

Besides, it just might be the oil producers, rather than consumers, who pay the greatest portion of any new tax on gasoline. If we assume that the current price is the maximum that oil companies and producing countries feel is consistent with maximizing their profits, then a new tax would not increase the price at the pump, already at the highest level consistent with maximum profits, but would force the crude oil component down. After all, if there were room to raise prices, you can bet the oil producers, not famous for their charitable instincts, would already have done so. Any new tax would have less effect in the long run on prices at the pump than on who gets the proceeds — the U.S. government, or Saudi princes and a Venezuelan dictator. I know: this sounds great in theory, but won't work out in practice. Certainly not to the last penny. But if you doubt this general tendency, ask yourself: If a new ten-cent tax on gasoline can simply be added to the present price without reducing demand, why don't the oil companies raise prices by a dime right now?

There is still another reason conservatives should end their opposition to carbon taxes: the absence of such taxes results in the sort of distortion that those who believe markets are the most efficient mechanisms for allocating resources abhor. Even if we are uncertain about the reliability of the data underlying the thesis that the earth is warming, even if we are uncertain that any such warming results from burning fossil fuels, even if we believe that a warming globe will merely redistribute incomes (winters in sunny Maine, increased wheat production in Canada, rising property values in areas that have become ocean front!), we have to recognize the possibility that we might be wrong, and that the much-derided environmentalists just might be right. Given that possibility, good policy surely includes putting a price on carbon that reflects any costs its use imposes on society — and if you think environmental costs are zero, and are certain you are right, throw in something for security costs — so that alternatives such as conservation and nuclear power can compete on a level playing field.

A tax on carbon, whether it takes the form of a levy on emissions, or a second-best substitute, a tax on gasoline, would accomplish a host of conservative goals.

Get the prices right and let competition rip. The likely result will be an energy economy less dependent on imported oil, increased incentives to clean up coal or reduce its use, lower consumption of gasoline, greater reliance on nuclear if it can be competitive with properly priced coal, more use of natural gas, and increased reliance on conservation. This process of sorting out winners and losers is surely superior to having the government substitute its judgment.* Because carbon is not priced into the cost of energy consumption — indeed, such consumption is enhanced by the variety of net

* " What is needed is not government experts picking winners (who fail), but a sensible scheme of taxation that allows any entrepreneur a decent return on investment …", Richard A. Epstein, *Carbon Dioxide: Our Newest Pollutan*t, Chicago: John M. Olin Law & Economics Working Paper No. 526 (2d series), August 2010, p.827. Updated version of article in *Suffolk University Law Review*, Vol. XLIII, No. 4, 2010.

subsidies accorded the oil industry — we cannot know just how competitive solar, wind and other renewable sources of energy would be in a non-distorted market, or whether they are a drag on the efficiency of the energy economy. Advocates of wind and solar energy — at least those whose preference for these sources is not quasi-theological — justify taxpayer-funded subsidies on the grounds that the costs of carbon emissions are not priced into fossil fuels. They are right about that, but wrong about their solution. If any environmental and security costs of fossil-fuel use are not internalized in the prices of these fuels, get the prices right, instead of subsidizing energy sources that are less carbon intensive.

So conservatives who do not believe the earth is warming, but do worry about the security threat of our reliance on foreign oil, and the rising cost of protecting those sources; who want to reduce the flow of funds to those who would do us harm; who do prefer to tax consumption, especially consumption of possibly polluting goods, to taxing work and jobs; who oppose rationing; and who prefer the price system to having the government pick winners worthy of subsidies, or have a hyper-active EPA attempt to accomplish by regulation what can more efficiently be accomplished by the price system, should grasp the opportunity and line up with the greens to support taxes that would reduce fossil fuel consumption.

Let me add another reason for the more pragmatic conservatives. Everyone knows that the eventual deal on entitlements, if there is to be one, will involve some combination of spending cuts and tax increases. Wouldn't some sort of tax on carbon be preferable to almost any other tax you can imagine? And if you worry about aborting the recovery, set the tax low at first, say at the $8-per-ton level that most experts agree is low indeed, and have it escalate as the unemployment rate declines.

I have no illusions: many conservatives will find these ideas uncongenial, in which case I look forward to alternative suggestions that will accomplish these multiple goals, long on the conservative wish list.

About the Author

Irwin Stelzer is a Senior Fellow and Director of Hudson Institute's economic policy studies group. Prior to joining Hudson Institute in 1998, Stelzer was resident scholar and director of regulatory policy studies at the American Enterprise Institute. He also is the U.S. economic and political columnist for The Sunday Times *(London) and* The Courier Mail *(Australia), a contributing editor of* The Weekly Standard, *a member of the Advisory Board of The American Antitrust Institute and a member of the Visiting Committee of the Harris School of Public Policy Studies at the University of Chicago.*

Stelzer founded National Economic Research Associates, Inc. (NERA) in 1961 and served as its president until a few years after its sale in 1983 to Marsh & McLennan. He also has served as a managing director of the investment banking firm of Rothschild Inc., a director of the Energy and Environmental Policy Center at Harvard University, has been a member of the board of the Regulatory Policy Institute (Oxford) and an advisor to the U.S. Trade Representative.

As a consultant to several U.S. and United Kingdom industries with a variety of commercial and policy problems, Stelzer advises on market strategy, pricing and antitrust issues, and regulatory matters.

His academic career includes teaching appointments at Cornell University, the University of Connecticut, and New York University. He has been elected a Visiting Fellow at Nuffield College, Oxford. He is a former member of the Litigation and Administrative Practice Faculty of the Practicing Law Institute. He served on the Massachusetts Institute of Technology Visiting Committee for the Department of Economics, and has been a teaching member of Columbia University's Continuing Legal Education Programs.

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