

# Carbon and Energy Taxes as a Revenue Source for California

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# Fundamental Goals of Taxation

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Raise revenue to match government expenditures

Minimize regressivity

Fairness of impact on wealthy versus poor

Achieve fairness across regions and sectors

Minimize economic distortion

Taxes can destroy economically valuable trade

Correct market failures that have led to mispriced goods or services

# Distortionary Taxes versus Corrective Taxes

Not all taxes cause economic distortions

Corrective taxes can reduce pricing distortions in the economy and improve economic performance

The price of pollution is often zero

Pricing pollution improves economic performance

Other “externalities”

Congestion: highway tolls, parking meters

Poor Driving: traffic tickets

Corrective taxes improving economic performance even if the revenue is rebated to citizens on a per capita basis

But corrective taxes are especially valuable if the revenue can be used to reduce distortionary taxes.

This is known as the “double dividend”

# Taxing Carbon versus Tradable Carbon Permits (“cap-and-trade”)

“Economists” do not favor taxes over permits

In practice, they are very similar programs

Same enforcement issues

Both will raise energy prices

Both can be used to raise revenue, or not

Annual permit auctions create a stream of revenues

Current debate over auctioning vs. allocating permits in cap-and-trade system

About fairness and short-term disruption, not efficiency

Argument for allocation is the losses imposed on firms

Those will be only partial and only short term

Solution: allocate some initially, then ramp down over time

# Targeting revenue from energy or carbon taxes (or permits)

Targeting revenues may be politically attractive, but it is bad economic policy

The tax level necessary to correct an externality can generate revenues greater or less than the need for government expenditures to address related issues

Over time, targeted tax revenues and justifiable expenditures in the targeted area are unlikely to change by the same amount

# Regressivity of Energy/Carbon

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## Taxes

Probably more regressive than sales taxes,  
definitely more regressive than progressive  
income taxes

But regressivity can be offset by reducing  
other taxes on low-income households

Increase standard deduction on state income tax

# Revenue stability from energy or carbon taxes (or permits)

Energy consumption is fairly insensitive to macroeconomic fluctuations

Excise taxes on energy/carbon (or permits auctions) create relatively stable revenues

Revenue from percentage sales taxes will be more volatile

Revenue volatility is a separate issue from concerns about competitiveness and leakage

And from secular trend away from fossil fuels

# State Competitiveness and

“**Leakage?**” State-level taxation of any activity raises concerns that the activity (or people) will leave the state

- Sales taxes

- Corporate and personal income taxes

- Property taxes

Energy/carbon taxes raise the same issues

- Some energy taxes are more avoidable than others

  - Transportation fuels versus electricity generation

Harsh reality: taxes raise the cost of doing business

Pleasant reality: government services lower the cost of doing business

Striking the right balance is challenging

- Taxes versus government services

- One sector versus another

- But corrective taxes should still be considered first

# California energy/carbon taxes (or permits) in the national context

Layering of taxes could create excessive cost

This is a real coordination concern, but it is not “regulatory chaos” or “conflicting standards”

Should California have a climate change initiative at all?

Not to directly reduce GhGs (CA<2%)

To demonstrate leadership, push the feds

Show that it won't be very expensive and has advantages

To move the CA economy where the rest of the world will eventually have to go (??)

Climate change externality is not local, so the argument is not the same as for smog or congestion