Climate Leadership Council

THE CONSERVATIVE CASE FOR CARBON DIVIDENDS

How a new climate strategy can strengthen our economy, reduce regulation, help working-class Americans, shrink government & promote national security

James A. Baker, III
Martin Feldstein
Ted Halstead
N. Gregory Mankiw
Henry M. Paulson, Jr.
George P. Shultz
Thomas Stephenson
Rob Walton

February 2017

ABOUT THE AUTHORS

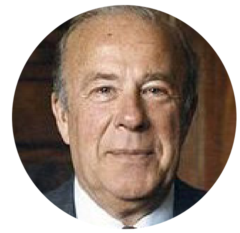
JAMES A. BAKER, III, served as Secretary of State under President George H.W. Bush, Secretary of the Treasury under President Reagan and White House chief of staff under both. He is a senior partner in the law firm of Baker Botts.

MARTIN FELDSTEIN served as Chairman of the President's Council of Economic Advisers from 1982 to 1984 under President Reagan. He is the George F. Baker Professor of Economics at Harvard University and President Emeritus of the NBER.

TED HALSTEAD is the founder, President & CEO of the Climate Leadership Council. Previously, he founded New America, a leading public policy think tank. He is co-author of *The Radical Center: The Future Of American Politics.*

N. GREGORY MANKIW served as Chairman of the President's Council of Economic Advisers from 2003 to 2005 under President George W. Bush. He is the Robert M. Beren Professor of Economics at Harvard University.

HENRY M. PAULSON, JR., served as Secretary of the Treasury under President George W. Bush. Previously, he served as chairman and chief executive officer at Goldman Sachs. He is the founder and chairman of the Paulson Institute.



GEORGE P. SHULTZ served as Secretary of State under President Ronald Reagan, and as Secretary of Treasury and Labor under President Nixon. He is the Thomas W. and Susan B. Ford Distinguished Fellow at the Hoover Institution.

THOMAS STEPHENSON is a partner at Sequoia Capital, a venture capital firm based in Silicon Valley. Stephenson previously served as the United States Ambassador to Portugal from 2007 to 2009 under President George W. Bush.

ROB WALTON served as chairman of the board of Walmart, the world's largest retailer and employer, from 1992 to 2015. He is currently Chairman of the Executive Committee of Conservation International.

ABOUT THE CLIMATE LEADERSHIP COUNCIL

The Climate Leadership Council is an international research and advocacy organization whose mission is to mobilize global opinion leaders around the most effective, popular and equitable climate solutions. As a central part of this mission, the Council develops and promotes new policy frameworks based on carbon dividends for each of the largest greenhouse gas emitting regions. Currently active in Washington and London, the Council will expand to Berlin, Beijing and New Delhi next. Find out more at www.clcouncil.org.

THE NEED FOR A CONSERVATIVE CLIMATE SOLUTION

Mounting evidence of climate change is growing too strong to ignore. While the extent to which climate change is due to man-made causes can be questioned, the risks associated with future warming are too big and should be hedged. At least we need an insurance policy. For too long, many Republicans have looked the other way, forfeiting the policy initiative to those who favor growth-inhibiting command-and-control regulations, and fostering a needless climate divide between the GOP and the scientific, business, military, religious, civic and international mainstream.

Now that the Republican Party controls the White House and Congress, it has the opportunity and responsibility to promote a climate plan that showcases the full power of enduring conservative convictions. Any climate solution should be based on sound economic analysis and embody the principles of free markets and limited government. As this paper argues, such a plan could strengthen our economy, benefit working-class Americans, reduce regulations, protect our natural heritage and consolidate a new era of Republican leadership. These benefits accrue regardless of one's views on climate science.

THE FOUR PILLARS OF A CARBON DIVIDENDS PLAN

1. A GRADUALLY INCREASING CARBON TAX

The first pillar of a carbon dividends plan is a gradually increasing tax on carbon dioxide emissions, to be implemented at the refinery or the first point where fossil fuels enter the economy, meaning the mine, well or port. Economists are nearly unanimous in their belief that a carbon tax is the most efficient and effective way to reduce carbon emissions. A sensible carbon tax might begin at $40 a ton and increase steadily over time, sending a powerful signal to businesses and consumers, while generating revenue to reward Americans for decreasing their collective carbon footprint.

2. CARBON DIVIDENDS FOR ALL AMERICANS

All the proceeds from this carbon tax would be returned to the American people on an equal and monthly basis via dividend checks, direct deposits or contributions to their individual retirement accounts. In the example above, a family of four would receive approximately $2,000 in carbon dividend payments in the first year. This amount would grow over time as the carbon tax rate increases, creating a positive feedback loop: the more the climate is protected, the greater the individual dividend payments to all Americans. The Social Security Administration should administer this program, with eligibility for dividends based on a valid social security number.

3. BORDER CARBON ADJUSTMENTS

Border adjustments for the carbon content of both imports and exports would protect American competitiveness and punish free-riding by other nations, encouraging them to adopt carbon pricing of their own. Exports to countries without comparable carbon pricing systems would receive rebates for carbon taxes paid, while imports from such countries would face fees on the carbon content of their products. Proceeds from such fees would benefit the American people in the form of larger carbon dividends. Other trade remedies could also be used to encourage our trading partners to adopt comparable carbon pricing.

4. SIGNIFICANT REGULATORY ROLLBACK

The final pillar is the elimination of regulations that are no longer necessary upon the enactment of a rising carbon tax whose longevity is secured by the popularity of dividends. Much of the EPA's regulatory authority over carbon dioxide emissions would be phased out, including an outright repeal of the Clean Power Plan. Robust carbon taxes would also make possible an end to federal and state tort liability for emitters. To build and sustain a bipartisan consensus for a regulatory rollback of this magnitude, the initial carbon tax rate should be set to exceed the emissions reductions of current regulations.

HELPING WORKING-CLASS AMERICANS

President Donald J. Trump's electoral victory stems in large part from his ability to speak to the increasing frustration and economic insecurity that many voters feel the political establishment has failed to address. This frustration has found expression in a growing populist sentiment and yearning for fundamental change. A carbon dividends plan responds to these powerful trends.

Relieving Economic Anxiety

Today's economic insecurity is driven by both technological progress and globalization. As such, it does not lend itself to easy answers. A carbon dividends program provides a rare exception: a simple idea that strengthens the economy and elevates the economic prospects of the nation's disaffected. The Department of Treasury estimates that the bottom 70% of Americans would come out ahead under such a program. Carbon dividends would increase the disposable income of the majority of Americans while disproportionately helping those struggling to make ends meet. Yet these dividends are not giveaways; they would be earned based on the good behavior of minimizing our carbon footprints.

Redirecting Populism

Increasingly, voters feel that the American political and economic system is rigged against their interests. Populism threatens the current policy consensus in favor of liberalized trade and investment. The best remedy is to redirect this populist energy in a socially beneficial direction. Carbon dividends can do just that based on a populist rationale: We the People deserve to be compensated when others impose climate risks and emit heat-trapping gases into our shared atmosphere. The new ground rules make intuitive sense: the more one pollutes, the more one pays; the less one pollutes, the more one comes out ahead. This, for once, would tip the economic scales towards the interests of the little guy.

> " *Carbon dividends would increase the disposable income of the majority of Americans while disproportionately helping those struggling to make ends meet*

STRENGTHENING OUR ECONOMY

Incentivizing Growth & Innovation

An ideal climate strategy would simultaneously reduce carbon emissions and steer America towards a path of more durable economic growth. A carbon dividends plan can do exactly that. A carbon tax would send a powerful market signal that encourages technological innovation and large-scale substitution of existing energy and transportation infrastructures, thereby stimulating new investment. Second, the plan would offer companies, especially those in the energy sector, the predictability they now lack, thus removing one of the most serious impediments to longer-term capital investment. Third, because many regulations would become unnecessary, the plan would give companies the flexibility to reduce emissions in the most efficient way.

> " *This plan would steer America towards more durable economic growth by encouraging technological innovation and stimulating new investment*

The Immediate Impact of Future Policy

A well-designed carbon dividends plan would further contribute to economic growth through its dynamic effects on consumption and investment. Just as central banks rely on forward guidance to influence future market expectations, if investors know that a carbon tax will increase steadily over time, the stimulatory effect of the final tax rate would be felt almost immediately for infrastructure and utility projects, especially ones that have long-term paybacks. In addition, forward-looking households would have an incentive to borrow to make durable purchases that would reduce their carbon footprint. Congress might even consider allowing individuals to borrow against their future dividend income for certain clearly defined purposes, such as higher education or the purchase of an electric vehicle.

SHRINKING THE SIZE OF GOVERNMENT

Less Government, Less Pollution

In order to separate the consideration of carbon taxes from debates over size of government, most carbon tax proposals are now revenue-neutral. This proposal, however, would go one step further by shrinking the overall size of government and streamlining the regulatory state. Eliminating or phasing out an array of energy-related regulations would reduce government bureaucracy, promote economic growth and free up the financial and personnel resources now allocated to administer and comply with these programs. A gradually increasing carbon tax would also eliminate the rationale for ever more heavy-handed regulations of greenhouse gas emissions in future years.

The Essential Link Between Carbon Taxes, Dividends & Regulatory Relief

For the elimination of heavy-handed climate regulations to withstand the test of time and not prove highly divisive, they must be replaced by a market-based alternative. Our policy is uniquely suited to building bipartisan and public support for a significant regulatory rollback. It is essential that the one-to-one relationship between carbon tax revenue and dividends be maintained as the plan's longevity, popularity and transparency all hinge on this. Allocating carbon tax proceeds to other purposes would undermine popular support for a gradually rising carbon tax and the broader rationale for far-reaching regulatory reductions.

STABILIZING AN UNSTABLE WORLD

Our reliance on fossil fuels contributes to a less stable world, empowers rogue petro-states and makes us vulnerable to a volatile world oil market. Carbon dividends would accelerate the transition to a low-carbon global economy and domestic energy independence. Not only would this help prevent the destabilizing consequences of climate change, it would also reduce the need to protect or seek to influence politically vulnerable oil-producing regions. With our electric grids susceptible to cyber attacks, a transition to cleaner power sources combined with new distributed storage technologies could also strengthen national security. Carbon pricing would also encourage domestic nuclear energy, further promoting climate stability and America's energy independence.

> “ *Many carbon tax proposals are revenue-neutral. This proposal goes one step further by shrinking the overall size of government and streamlining the regulatory state*

CONSOLIDATING CONSERVATIVE LEADERSHIP

A Popular Solution to a Widely Shared Concern

The opposition of many Republicans to meaningfully address climate change reflects poor science and poor economics, and is at odds with the party's own noble tradition of stewardship. A carbon dividends plan could realign the GOP with that longstanding tradition and with popular opinion. Recent polls indicate that 64% of Americans worry a great deal or a fair amount about climate change, while a clear majority of Republicans acknowledge that climate change is occurring. Meanwhile, one telling survey finds that 67% of Americans support a carbon tax with proceeds returned directly to them, including 54% of conservative Republicans.

Appealing to Younger Voters, Latinos & Asians

Concern about climate change is greatest among Americans below the age of 35, Latinos and Asians. And it is, of course, younger voters who hold the key to the future political fortune of either party. Increasingly, climate change is becoming a defining issue for this next generation of Americans, which the GOP ignores at its own peril. Meanwhile Asians and Hispanics – the fastest growing demographic groups – are also deeply concerned about climate change. A carbon dividends plan offers an opportunity to appeal to all three key demographics, while illustrating for them the superiority of market-based solutions.

POLICY FINE PRINT

A carbon tax should increase steadily and predictably over time so that companies and consumers can plan accordingly, and the previously mentioned economic stimulatory effects can be harnessed. At the completion of a five year period, a Blue Ribbon Panel could recommend whether the tax rate should increase further, based on the best climate science available at the time. Provisions must be established for the unbanked to receive their monthly dividend checks, possibly through commercial services such as PayPal or Western Union. The dividend income should be tax-free. Exports by companies in sectors with greater than 5% energy cost in final value should have any carbon taxes rebated on leaving the United States. Finally, non-emissive fossil fuel products (e.g. asphalt for road use) should be exempt, with a refund for any tax previously paid.

> *With the privilege of controlling all branches of government comes a responsibility to exercise wise leadership on climate policy and promote a solution that showcases the full power of enduring conservative convictions*

THE IMPERATIVE TO LEAD

With the privilege of controlling all branches of the government comes a responsibility to exercise wise leadership on the defining challenges of our era, including global climate change. It is incumbent upon the GOP to lead the way rather than look the other way. Republicans now have a rare opportunity to set the terms of a lasting market-based climate solution that warrants bipartisan, industry and public support. No less important, this is an opportunity to demonstrate the power of the conservative canon by offering a more effective, equitable and popular climate policy based on free markets, smaller government and dividends for all Americans.

Climate Leadership Council