

Message

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Sent: 15/11/2016 16:19:01
To: Nolan, James [/O=MSXBP/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/[REDACTED]]; Ellis, Joe [/O=MSXBP/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/[REDACTED]]
CC: Stout, Robert [/O=MSXBP/OU=EXCHANGE ADMINISTRATIVE GROUP (FYDIBOHF23SPDLT)/CN=RECIPIENTS/[REDACTED]]
Subject: RE: Niskanen carbon tax article - discusses lessons from failure of the WA carbon tax

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From: Nolan, James
Sent: Tuesday, November 15, 2016 7:52 AM
To: Ellis, Joe; Moran, Ralph J
Cc: Stout, Robert
Subject: Niskanen carbon tax article - discusses lessons from failure of the WA carbon tax

What do you think of Jerry's analysis?

NOVEMBER 15, 2016

CARBON TAX, RIP?

BY JERRY TAYLOR

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Going into last week's election, the political table in both chambers of Congress seemed well suited for a grand bargain on climate change: elimination of EPA regulatory authority over most greenhouse gas emissions in return for a carbon tax. When asked by *Politico* this summer what he thought of these increasingly meaningful backroom

conversations—conversations which had become serious enough to prompt a police operation from the House Republican leadership—the powerful chairman of the Environment and Public Works Committee and leading opponent of climate action, Sen. James Inhofe (R-OK), refused to rule a deal out. On the eve of the election, Tom Pyle, the head of the hard-right Institute for Energy Research (a 501(c)(3) arm of the (c)(4) American Energy Alliance), told the trade press that this prospective grand bargain was the biggest threat his fossil fuel allies faced in the next Congress. While organizations like the Niskanen Center worked to make that deal a reality, our friends in Washington state—engaging in a shoe-string operation—looked poised to pass a variation of that plan via a state ballot initiative. Going into last week, the initiative (I-732) was opening up a lead in the polls, suggesting that a carbon tax was not quite as politically toxic as many have thought.

Well, you know what happened. A candidate who claimed that climate change was a hoax led a resurgent Republican party to a stunning victory. And I-732 was clobbered with 59 percent of voters in that deep-blue state voting “no.” It would appear that, with Republicans promising to withdrawal from the Paris Accord on climate change, repeal the administration’s Clean Power Plan, and unleash domestic fossil fuel (and in particular, coal) production to the greatest extent physically possible, climate action in general—and carbon pricing in particular—is now in deep political hibernation.

While that is likely the case, the political and policy arguments for carbon taxation remain and political futures are never certain. Let’s examine what caused these defeats in the course of thinking about how they might be reversed in the future.

Washington’s State Carbon Tax Initiative

Initiative 732 (a \$25 per ton carbon tax, increasing by 3.5 percent annually until it hit \$100 per ton by mid-century) was beaten by an odd left-right coalition made up of establishment environmentalists, social justice activists, labor unions, leading state Democrats, climate crusaders Van Jones, Naomi Klein, and Tom Steyer, and ... the state business community, the fossil fuels industry, hard-right climate skeptics, and Koch Industries. As perhaps best explained by *Vox*’s David Roberts, the environmental establishment in Washington state found itself breaking bread with the fossil fuels lobby because they cared more about advancing a progressive agenda than they cared about climate change itself. This, despite the fact that the sales tax cut that would follow from I-732, along with an annual tax refund of \$1,500 for low-income families, would do more to reduce income inequality in Washington than anything forwarded by the leftist opposition. But that wasn’t enough. As Becky Kelley, president of the Washington Environmental Council, put it, “Viewing climate change as an environmental body of work is way too limited. It’s not really an environmental issue, it’s a broad, societal and economic issue ... Climate policy is not environmental policy. It is everything policy.”

Many conservatives, who've long suspected that the environmental lobby is like a watermelon—green on the outside, red on the inside—saw their worst fears (or perhaps greatest hopes) confirmed in Washington. Any conservative embrace of climate action or a “grand bargain” to address global warming in a market-oriented fashion is naïve and dangerous, they concluded, leading either to futility or a fast track to socialism.

That reading of the left, however, ignores the fact that a lot liberals and environmentalists *outside* of the state thought that the opposition was nuts. “The left’s opposition to a carbon tax shows there’s something deeply wrong with the left,” editorialized *The Washington Post*. *The New York Times* also endorsed I-732. While most of the environmental establishment stayed conspicuously on the sidelines, some very notable exceptions—e.g., The Center for American Progress, the World Resources Institute, the National Audubon Society, and the Citizen’s Climate Lobby—broke ranks and sided with the initiative. Prominent environmentalists like Leonardo DiCaprio, James Hansen, Robert F. Kennedy, Jr., Steven Chu, and the crew at National Geographic’s *Years of Living Dangerously* did likewise. In the end, I-732 won in Seattle (though it lost in most other parts of the state), which suggests that liberal voters rallied around the plan even in the teeth of the progressive campaign against it.

I-732’s loss outside of Seattle, however, demonstrates the simple power of the argument that carbon taxes = higher electricity and gasoline prices = no good. Those assaults were effective but overwrought. The average change in electricity generation costs would be about 0.58 cents per kWh in a world in which average retail electricity prices in Washington are about 9 cents per kWh. This works out to 6.4 percent increase in prices, which is too small for ratepayers to notice. A \$25 carbon tax increases gasoline prices by about 25 cents, so when in full play by mid-century, the tax would increase fuel prices by about \$1.00 per gallon. This puts gasoline prices decades hence back where they were only a couple of years ago. The reductions in state sales taxes and the tax refund to low-income families would produce an economic wash for most households.

There are four lessons from the “Battle in Seattle.”

First—and most important—if carbon pricing is to move forward, compromises between disparate coalitions are absolutely necessary. Neither the left nor right is going to unilaterally steamroll the opposition and climate activists are not strong enough to entertain defections over secondary issues such as how carbon tax revenues should be spent.

Second, the progressive coalition between environmentalists and social justice advocates is weak and unstable. A thoughtful Republican carbon tax proposal can split the opposition and draw a not-insubstantial number of environmentalists into the conservative camp. The civil war that played out in Washington state is an invitation, not a warning, to conservatives who hope for more economically sensible climate policy.

Those on the right who don't think a climate deal is possible are simply not paying attention.

Third, public concern surrounding climate change is very widespread but not very deep. If climate change is truly the greatest threat facing humanity (and I think it is), then we need to start acting like it. Alas, too many of those who fancy themselves as carrying this message don't behave in the political world as if it were true. This likely has something to do with the phlegmatic public reception (even in blue states) to meaningful policy action.

Fourth, carbon tax proponents need to craft a simple, direct response to the easy conservative argument that carbon taxes = high energy prices = bad news for you. They don't have one yet, but public opinion surveys suggest that this is not an impossible task. In a survey earlier this year from the Yale Program on Climate Change Communication, 68 percent of the public (and 47 percent of Republicans) supported imposing a carbon tax on fossil fuel companies and using those revenues to reduce other taxes. Those findings are somewhat more optimistic than, but still generally consistent with, findings produced by Anzalone Liszt Grove Research for the Clinton campaign in March, 2015 (58 percent expressed support for a carbon tax, 35 percent opposed). When Anzalone Liszt Grove gave those voters various pro and con arguments for a carbon tax, however, support fell to 46 percent with 45 percent in opposition.

The Trump Revolution

While Donald Trump was loud and proud on the campaign trail about his contempt for climate science in general and low-carbon energy in particular, there's little evidence that it had anything to do with his victory last week. While it continues to play well with the highly organized elements of the GOP base, the number of conservative Republicans who acknowledge that the climate is changing has increased from 28 percent in 2014 to 47 percent in 2016, a remarkable surge. Only one in ten Americans now say that climate change is *not* happening and only 18 percent of Republicans agree with the party leadership that climate change should be ignored by government.

More importantly, surveys consistently find that, even among conservative Republicans, support for government action to address greenhouse gas emissions greatly outpaces the public's embrace of the scientific consensus surrounding climate change. According to one representative survey, 75 percent of registered voters (61 percent of Republicans and 53 percent of conservative Republicans) support regulating carbon dioxide emissions as a pollutant.

Although the issue remains a low priority for most voters relative to other issues (only about 13 percent of prospective voters going into the election booths last week rated global warming as a top issue when casting a ballot, and that includes people who are for climate action *and* against it) there is no longer any downside for politicians to talk aggressively about tackling climate change. That's because only about 5 percent of these

climate voters feel passionately that global warming doesn't exist. The other 95 percent see it as perhaps the most important issue facing the planet.

The political saliency of climate change, meanwhile, is slowly climbing. Surveys find that the environment and climate change were more important to voters in 2016 than race relations, gay marriage, taxes, and abortion. And in states like Florida, which are being impacted most directly by climate change, it was the second most important issue to voters, behind only the economy and jobs. Alas, while growing in importance, it still wasn't important enough.

We will now (barring an impeachment, which is unlikely but not unimaginable) have four years of Donald Trump. As my colleagues David Bookbinder and David Bailey pointed out yesterday, it will prove a difficult legal and political task for the new administration to shut-down existing climate action. While it's true that the climate clock is ticking, the lack of ambition associated with the Obama climate program, and the international community Post-Paris, suggests that there will likely still be time, post-Trump, to repair the policy damage.

Carbon Taxation in the 115th Congress

Prior to last week's vote, there were about a dozen Republicans in the Senate and perhaps 40 in the House who were uncomfortable with the orthodox denialist line in the party. Almost all of those members are coming back for the 115th Congress. Their opinions have not changed.

While there was (and probably, at present, is) no unanimity with rebel ranks about the optimal policy pivot, a Republican carbon tax initiative was nearly certain in both chambers in 2017 had Hillary Clinton won the election. There were three major political factors driving carbon taxation within the party before last week. One-and-a-half remain.

The first was the likelihood that the Obama administration's Clean Power Plan (CPP) (which, despite its lack of policy ambition, is hated by Republicans with the white-hot intensity of a thousand suns) would survive in the courts and prove politically impossible to overturn by conservative legislative force. Only the prospect of a carbon tax could tempt Democrats to abandon the CPP, and that trade would be good for Republicans because it would produce less costly emission reductions and hold out hope for saving the coal sector. With the CPP almost certainly dead for the next four years, that driver is no longer in play.

The second was the fear that the advantages of embracing denialism (firing up the hard-right, populist base) was outweighed by the costs (taking a position that was wildly unpopular with most voters and increasingly salient). The fact that many of our Republican friends in the "rebel" camp campaigned to some extent on climate being a real problem that demanded answers suggests that this driver is still in play. But for most Republicans, no discernible price was paid for denialism, and "saving coal" likely

resonated with working class white voters in rural Appalachia and certain western states. Until that changes, there is little (political) reason for the party as a whole to second-guess its alliance with the anti-climate members of its coalition.

The third was personal conviction that climate change is a real and present danger. Believe it or not, many politicians come to Washington to do good, and—believe it or not—a number of elected Republicans will tell you in private that they know full well that climate change is not a hoax and not a trivial matter, no matter what they say in public. It seems like ancient history now, but remember that the Republican leadership was poised to price carbon in an aggressive fashion in the late 2000s before the Tea Party came upon the scene and shut that conversation down. Republican climate champions like John McCain (R-AZ) and Jeff Flake (R-AZ) didn't change their minds; they simply went quiet. A lot of them are still around and waiting for an opportunity to help move the country off a very dangerous environmental path. Alas, with Donald Trump in the White House, that job is now more difficult than ever.

Although Donald Trump has on more than a few occasions this year sworn eternal hostility to a carbon tax, it's not impossible to imagine that Mr. "Art of the Deal" will find himself embracing exactly that. In a post-election analysis, ClearView Energy Partners warns against ruling out a carbon tax as part of a broader tax reform in the next Congress. Rep. Kevin Cramer (R-ND), an important advisor to the President-elect on energy policy, likewise suggested that a carbon tax could well be in play in the course of tax reform.

How could this be? Simple. There are only three sources of new revenue potentially large enough to offset the revenue losses associated with the tax cuts sought by Republicans. The Congress can:

- slash tax breaks and deductions as was done in the course of the Tax Reform Act of 1986,
- impose a value added tax (VAT), or
- impose a carbon tax.

That's pretty much it. Of those three options, a carbon tax is likely the *easiest* of three hard political lifts. But this scenario only makes sense if we presuppose that Republicans *care* about offsetting revenue losses with increased tax revenue from other sources.

Given that many of Donald Trump's economic advisors believe that will be unnecessary, it's not obvious that Republicans will be in the market for a carbon (or any other) tax.

Another avenue to a deal would be a straight-up trade; EPA regulatory authority to address greenhouse gases under the Clean Air Act (CAA) for a carbon tax. This would make sense if Republicans fail to amend the CAA and they subsequently worry (rightly) that, thanks to *Massachusetts vs. EPA*, they'll be right back under the regulatory gun as soon as the Democrats retake the White House. This deal might make more sense now

because the Republicans, rather than the Democrats, have most of the political cards. If you're one of those who thinks that the Democrats would never accept such a deal (an argument often made by climate skeptics, implying that it would be bad for the left but good for the right), they most certainly might if the alternative is a non-zero chance of permanent evisceration of the CAA. As long as Republican rollback of CAA authority over greenhouse gases is uncertain, both sides have an incentive to contemplate a deal.

Accordingly, one can imagine carbon taxes becoming a live issue in the next Congress. But more likely than not, it won't happen. Republicans have never been that interested in offsetting revenue losses from tax cuts. Conservatives will likely be hypnotized by the political possibility (however unlikely) of permanently eliminating federal regulatory authority over greenhouse gas emissions. And the right will continue to oppose carbon pricing and fall into what University of Texas law professor Gary Lucas calls the behavioral public choice trap. This would be, according to Lucas, a "Pyrrhic victory ... Rather than averting major government action on global warming, defeating the carbon tax will very likely facilitate adoption of more costly substitutes that the public strongly favors as a result of cognitive bias."

The Ministry of Defense

Carbon taxes are the most efficient and least costly means of achieving greenhouse gas emissions reductions and hedging against climate risk. But if carbon pricing is off the political table, those of us who accept the narratives offered by 97 percent of the scientists who work in this field have no choice but to embrace second-best policy alternatives. A paper published this month by energy economist Robert Pindyck suggests that anything reducing emissions at a cost of \$80-\$100 per ton is very defensible (a finding consistent with a paper released last month by economists Kent Daniel, Robert Litterman, and Gernot Wagner), while mitigation costs of up to \$200 per ton are still not unreasonable. According, a wide scope of climate policies that we might otherwise deem inefficient (at least, relative to a carbon tax) are worth embracing in our brave new Trumpian world.

While the Trump administration may make carbon pricing unfeasible in Washington, it's still a live option at the state level. About 30 percent of the U.S. economy is subject to carbon pricing via cap-and-trade regimes in California and the nine northeastern and mid-Atlantic states party to the Regional Greenhouse Gas Initiative. Legislation to adopt carbon taxation is pending in Massachusetts, New York, Rhode Island, and Vermont. A federal retreat away from climate action will likely turbocharge political efforts in those and other states.

Finally, there is the option of legal action via common law, and those options are perfectly consistent with libertarian beliefs about the imperative to defend property rights via common law remedies. While many libertarian thinkers believe (probably wrongly) that common law suits are in fact the first-best libertarian answer to climate change, those

suits have in the past been championed by environmentalists. The most important of those suits, *AEP vs. Connecticut*, was rejected by the Supreme Court in 2011 because the Clean Air Act was found to have authority over greenhouse gas emissions. As my colleagues David Bookbinder and David Bailey note, “Eliminating that regulatory authority would revive those claims and raise the specter of both unknown financial liability and, eventually (the wheels of justice may grind slowly but they do grind on), potential judicial determination of the appropriate emissions levels for all of the nation’s power plants.”

The political and policy case for climate action and carbon taxation remains, regardless of what happened at the voting booths this month. And that case resonates regardless of how one feels about individual liberty, capitalism, or the role of government.

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