Ten Principles for Successful Carbon Pricing

Investment in new technologies and infrastructure is essential to reduce our dependence on fossil fuels, but it is not enough. Decarbonization also requires progressively raising the cost of fossil fuels until they are no longer competitive with clean energy. Otherwise, we will get the problem of *rebound*: when I use less coal or oil, that reduces the price and makes it more attractive for someone else to use.

Here are ten principles for doing carbon pricing right:

1. Cap, don't tax.

There are two ways to send the needed price signal. One is to establish a schedule of gradually rising carbon taxes or fees. The other is to set up a cap-and-permit system and gradually reduce the number of permits. The most important difference is that a cap-and-permit system can accurately achieve science-based carbon reduction targets, whereas taxes alone cannot. We can only guess how high prices need to go to hit emission reduction targets.

2. Set a price floor, but not a hard ceiling.

Setting a rising floor on the carbon permit price will help reduce price volatility and simplify business planning. (Businesses will understand that in the long run, carbon prices will only go up.) Setting a ceiling on the carbon price, however, would defeat the cap's purpose: to guarantee achievement of the carbon reduction targets.

3. Do it upstream.

The simplest way to price carbon is to apply the cap (or tax) on the *first sellers* of carbon-based fuels, not on the ultimate emitters. That's because there are millions of emitters and only a small number of first sellers (oil, gas and coal companies), and the first sellers are easily identified. If we control how much carbon comes *into* our economy, we control how much goes out.

4. Auction permits.

Carbon permits are valuable goods. They should be auctioned rather than given away for free. Auctioning will ensure efficient allocation of permits, eliminating the need for trading—see #6 below. Moreover, the revenue from auctions can be used to fund dividends—see #8 below.

5. Use border adjustment fees.

To ensure a level playing field for U.S. companies, we should levy tariffs on imports from countries that don't have comparable carbon pricing, and rebate carbon revenues to support exports destined for those countries.

6. No trading!

When most people think of carbon capping systems they think of "cap and *trade*." But allowing trading complicates the system unnecessarily and opens opportunities for gaming. A well-designed auction system makes secondary markets unnecessary.

7. No offsets!

Offsets are seemingly eco-friendly things that carbon users can do in place of buying a permit or paying a fee, like planting trees. However, experience has shown that offsets are rarely effective and are susceptible to abuse. This is not to say that planting trees is a bad idea. It's just that activities like these should be undertaken *in addition to* reducing emissions, not *instead* of it.

8. Return 100% of revenue to households as dividends.

Raising the price of carbon will place a financial burden on households. The simplest and fairest way to ease that burden is to issue equal dividends from the revenues of the pricing system. This will ensure that carbon pricing doesn't punish the poor or middle class, but rather lifts them up.

Dividends should be *visible* (i.e., send by check or electronic deposit), not buried in tax credits or utility bill rebates. Visible dividends are essential to sustain public support for carbon pricing until climate stability is reached.

What about funding the Green New Deal? The Green New Deal deserves funding, but it shouldn't come from carbon pricing or other regressive taxes. Rather, it should come from progressive taxes, borrowing, or new money creation.

9. Make dividends taxable.

This will make carbon pricing more progressive and raise money for other programs.

10. Don't throw out other policies from the tool kit.

Carbon pricing is a *complement* to smart regulations, not a substitute. For example, pricing alone can't address the environmental justice concerns of low-income and minority communities that have been disproportionately affected by fossil fuel pollution.

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