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When environmental, trade and social policies meet

■The recent "economists' statement on carbon dividends" offers important policy prescriptions for the US to address global warming ■It explicitly refers to the need for a border carbon adjustment system so as to maintain competitiveness versus countries that would not have introduced a carbon tax ■The authors recommend that the carbon tax proceeds be equally distributed to US citizens ■It could be envisaged to use these proceeds in a way which takes into account the distributional aspects of environmental taxes whilst promoting energy efficiency investments

On 17 January The Wall Street Journal published the "Economists' statement on carbon dividends"[1]. It managed to grab the attention if only because of the impressive list of co-signatories[2]. They consider that a carbon tax is the most cost-effective instrument to reduce carbon emissions to a sufficient degree and pace, that it should replace less efficient regulations and that it should be increased every year until the emission reduction goals are met.

This gradualist approach should give households and companies time to adjust their behaviour and finance the necessary investments (heating, means of transportation, manufacturing processes). It implies that the cumulative increase in the carbon tax would depend on the price sensitivity of the demand for carbon intensive goods and services. The higher this sensitivity, the lower the required increase in the carbon tax.

Ideally such an approach should be adopted globally but experience has shown the difficulty of coming to a broad-based agreement and stick to it[3]. It implies that single-country measures would weaken the competitiveness of its companies and create an incentive for other countries not to do anything.

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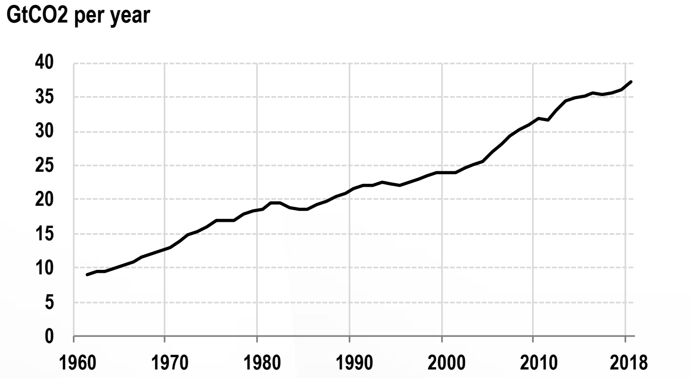
CLIMATE: CO2 EMISSIONS CONTINUE TO GROW



Source: Global Carbon Project

[1] https://www.clcouncil.org/economists-statement/
[2] The signatories include 4 former chairs of the Federal Reserve, 27 Nobel laureate economists, 15 chairs of the Council of Economic Advisers and 2 former Secretaries of the US Department of Treasury.
[3] In June 2016, the decision of Donald Trump to pull the US out of the COP21 agreement reached in Paris is just one illustration amongst many of the difficulties to come to a coordinated global approach.

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To address this coordination problem, the signatories call for the establishment of a border carbon adjustment system in which exports to countries which do not apply a carbon tax would receive a rebate whereas imports from these countries would be taxed when entering the country[4,5]. There is a concern however that other countries would consider a carbon tax on imports as a protectionist measure which has little to do with climate change, triggering retaliation measures.

The signatories also argue that it should be revenue neutral in order to avoid debates over the size of government and for this reason *"all the revenue should be returned directly to U.S. citizens through equal lump-sum rebates"*, the so-called carbon dividend. Considering that, quite likely, the carbon footprint of wealthier households is bigger than that of households at the lower end of the income distribution, an equal lump-sum rebate would imply that the latter would see an increase of their disposable income considering that the lump-sum rebate would be higher than the carbon taxes. This could create an incentive or at least facilitate energy efficiency investments on their behalf.

It can be argued however that the revenue neutrality is a matter of judgment. The government could consider it has an important role to play in fostering energy efficiency so it could use (part of) the carbon tax revenues to finance its own green investments (e.g. increase the energy efficiency of public buildings and schools). Alternatively they could be used to address the income distribution aspects of green taxation by e.g. subsidising energy efficiency investments of financially constrained households.

Clearly, these alternative approaches are less easy to explain than a lump-sum rebate for every household. The recommendations of the Economists' statement have the merit of replacing often complex existing regulations. In addition they show a direction which would allow to make considerable progress in terms of carbon emission reduction, at the initiative of a single country, thereby avoiding losing considerable time in addressing the international coordination problem, and with the added advantage of being able to take into account the distributional aspects as well.

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[4] Climate Leadership Council, *The conservative case for carbon dividends,* February 2017. The wording is reminiscent of the "destination-based border-adjusted cash flow tax" as proposed by Republican members of the House of Representatives in the US in 2017, which would have acted as the combination of an export subsidy and an import tariff.

[5] This is also discussed in a forthcoming article "Getting to a low carbon economy" of Raymond Van der Putten in Conjoncture (BNP Paribas) on January 2019.