



The Great Swap: Addressing Climate Change with a Carbon Tax

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Implementation of a carbon tax could begin with an advance rebate check for every American household, Professor Joe Aldy suggested in Monday's energy policy seminar, outlining ways in which a carbon tax might be appealing to many different constituencies. His proposal for a "[Great Swap](#)" could deliver a policy sweet spot that combats climate change, facilitates tax reform, and streamlines regulatory burdens that is relevant even in today's partisan political environment, Aldy said.

While acknowledging that it's "not clear how to start the conversation," Aldy argued that there are reasons why a number of diverse interest groups might be willing to support a carbon tax. The political case for a carbon tax, Aldy explained, can be thought of in terms of two different kinds of possible swaps—a swap of carbon tax revenues for other taxes, and a swap of carbon tax incentives for other regulations. Noting that an upstream tax on the carbon content of fossil fuels would be an administratively simple way to provide uniform incentives for carbon emissions reductions, Aldy focused on an "optimistic" review of the political considerations which might lead diverse interest groups to support such a policy—many of which tie back to the potential for such a tax to collect hundreds of billions of dollars per year, which could be used for rebates and/or tax reductions.



For progressive environmentalists grappling with projections that current regulatory policies will likely not be enough to meet 2025 emission reduction targets, a carbon tax offers an approach that might make such targets attainable, and that, if implemented along with a rebate program, could avoid the regressive economic impacts of some other approaches. At the same time, the idea of "swapping" a regulatory approach that environmentalists are used to working with and that has been effective in some cases may be a disincentive for this group to embrace the idea of a carbon tax, Aldy acknowledged.

For business, a carbon tax could offer increased regulatory certainty, Aldy noted, and might be less burdensome than the existing multi-faceted regulatory approach (assuming part of the "swap" might include reducing regulations). The additional revenues from a carbon tax could be used for tax reforms that might even result in a lower overall tax burden for some businesses. Not every business would benefit, Aldy noted, observing that a carbon tax "won't be a winner for coal."

For labor, Aldy noted three potential benefits: first, another possible use of carbon tax revenues might be to promote payroll tax reductions. At the same time, the carbon tax would benefit the wind industry, which is a source of demand for heavy manufacturing and steel. Finally, a carbon tax might be supplemented by border protection measures to compensate for imports from countries without such a tax.

A thoughtful approach to a carbon tax, Aldy observed, would need to include provisions that would allow it to be updated regularly. Aldy suggested that some of the streamlined approval procedures used by Congress for trade agreements might be useful for carbon tax adjustments, an idea he develops further in his paper, "[Designing and Updating a U.S. Carbon Tax in an Uncertain World.](#)"

Aldy spoke as part of the Kennedy School's Energy Policy Seminar Series, which is sponsored by the Consortium for Energy Policy Research of the Mossavar-Rahmani Center on Business and Government.