

Untaxing Questions

It seems to me a bit like buying indulgences from the ancient church. ... I can waste all the energy I want and then justify it by writing a check.

—Former Arkansas governor Mike Huckabee, 2007

THE CLIMATE IS CHANGING. The terrorists are coming. We've got to do something now. Grow more corn. Make hydrogen. Build nuclear reactors. Build solar roofs. Cap greenhouse gasses. Invent fusion reactors, zero-emission vehicles, nanotech this, and biotech that.

These ideas all sound so concrete and effective. But sound is about all we get. Ethanol makes things worse, the hydrogen bubble has burst, and zero-emission vehicles zeroed out. Still, there will always be new energy fads.

Carbon taxes and untaxes, on the other hand, are not fads. But it's hard to put your finger on just what they do. They quash the fads and accelerate ordinary, but effective, conservation and give wings to real breakthroughs. But I can't predict the breakthroughs, so it's hard to make an untax seem sexy. Still, perhaps I can at least rebut a few of the baseless criticisms that will surely hinder its acceptance

Indulgences from the Ancient Church?

Both carbon-emission permits and a carbon untax let polluters buy their way out of the energy policy. If you have the money, you can emit as much as you

want—or even more just to be spiteful. This strikes many people as immoral, so they dismiss market-based policies. As Huckabee puts it in this chapter’s opening quote, “I can waste all the energy I want and then justify it by writing a check.”

Although as an economist I should probably not admit this, I feel much the same way. I dislike seeing the rich abuse the environment for selfish reasons. In spite of this, I favor policies that let them do just that. My motive is practical. I have taken a close look at every way I can think of—more ways than I discuss here—to curb rich polluters, treat the poor fairly, and still make large cuts in oil use and carbon emissions.

I see no way to do all three. This requires a choice, and my choice is to curb carbon emissions and treat the poor fairly. The rich are beyond our control, so I say we should at least sell them indulgences. But let’s not give the money to the ancient church—or to the modern government either.

But why can’t we force the rich to do their part? If we imposed a 30 percent cut in carbon use on everyone—no exceptions—the rich could not wriggle out of that. It does seem unfair to the poor, who are already getting by with very little. But the real problem is that it can’t be done. How could we count up everyone’s carbon every year? Heating, driving, flying, boating, lighting—how could we count all that for every person? It’s just impossible. If you can’t count it, you can’t cut it 30 percent. The same problem applies if you require everyone to reduce their carbon use by the same number of tons. Plus, it would devastate the poor and not make much difference at all to the rich.

Since we can’t keep track of everyone’s carbon use, perhaps we can keep track of everything else. We could require that all cars get at least 30 miles per gallon. We could ban through-the-door ice makers on refrigerators, since they waste a lot of energy. We could restrict carbon use for heating and cooling to three tons of carbon per year per house. Or, if we don’t like this one-size-fits-all approach, we could set a different limit for each size of house in each part of the country. But how many miles of plane travel and driving should we allow? Obviously, this approach is a nightmare of regulation.

It is possible, though not a good idea, to use command and control regulation on large industries, but when it comes to individuals, it really does not make sense. The problem is that energy use reaches into every corner of our lives. Controlling the rich would require the government to check every corner. No one thinks that’s right, and fortunately, it’s completely unnecessary. We can actually do something that’s fair to both the rich and the poor—and that’s the untax. It lets the rich write checks, and when the refunds are given out equally, the poor get back more than they pay. I explain, in the next chapter, why this is exactly fair.

Do Consumers Care about Price?

A related objection to the untax is that it won't be only the rich who ignore it; everyone else will as well. Everyone is so addicted to fossil fuel, the thinking goes, that they will pay whatever it takes to get their fix. This is the pop-psychology approach to economics. Economists go a bit overboard assuming people are rational, while pop psychology sees people as irrational—but predictable. I'm as skeptical of predictable irrationality as I am of rationality. It's best to take an experimental approach to human behavior. Fortunately, the experiment has been done.

Looking back at the OPEC crisis, we find that OPEC had its effect on the world entirely by means of price. (OPEC didn't cause the lines at the gas stations, by the way. Misguided regulation in the United States did that.) Yes, OPEC pumped less oil, but the world oil market did what markets do and made sure that anyone could buy as much oil as they wanted—provided they paid the price. Think about this for a minute. OPEC supplied less oil, but that did not stop anyone from buying more oil. In every case, it was the price that stopped people from buying more. Prices tripled, then doubled on top of that. Price changed behavior, and the change was enormous.

Look back at Figure 3 in Chapter 8. It shows total U.S. energy use before and after the OPEC crisis. The figure is not a product of green conservationists, but of Dick Cheney's National Energy Policy Development Group—an organization dominated by energy-supply companies. If the OPEC crisis had not occurred, the United States would have used something like 165 quads of energy in 2000, according to Cheney's group. Instead, the United States used 100 quads that year—a savings of 65 quads. (A quad—for quadrillion British thermal units—is a whole lot of energy.) The data includes energy from all sources—fossil, nuclear, and alternative. So this graph shows just one thing—the effect of high prices on total energy use. The total energy saved is equivalent to almost two decades of oil use at the 2007 rate. In 2007, the United States used only 40 quads of oil.

Some will argue that this enormous impact is due to fuel-efficiency standards and other government programs. But consider two points. These programs would never have happened without the OPEC price hikes, and the government programs do not account for the bulk of the effect. In fact, when the Department of Energy checked energy impacts in 1980, it found that government programs had had almost no net impact on energy conservation but that price had been effective in encouraging energy savings (see “Energy Policy: Mostly Sound and Fury” in Chapter 7). The high prices imposed by OPEC saved vastly more energy than any other policy before or since.

But would that work again, with an untax? OPEC's price increase and an untax would have basically the same effect on energy prices. The main

difference is the refund checks. Getting the refunds means we have more money to spend. True, we can expect to spend about 5 percent of that money on fossil energy, as we do with other income. But surely it makes no sense to let OPEC set the high prices for us and then give away \$100 billion to OPEC members. It's far better to charge our selves the \$100 billion, refund that money to ourselves, and then not worry that we will spend \$5 billion of it on fossil fuel.

The bottom line is that the untax will work 95 percent as well as OPEC's high oil prices for encouraging conservation, and the only way to raise that to 100 percent is not to give consumers the untax refund. In fact, because the untax targets coal as well as oil, the untax will work better than OPEC's oil-price increases.

On the other hand, though, because the nation is wealthier now, the same high carbon price will probably have less effect than last time. But being wealthier is not a bad thing. On balance, it helps more than it hurts and will make the transition to alternative fuels easier than it would have been in the past.

What's the Psychology of the Untax?

The objection that everyone will ignore the untax because they are addicted to fossil fuel—that the untax is too small to matter—is based on a view of people that lumps them into a few types, sometimes even just two types. For example, some people like SUVs, and some like small cars. The SUV owners won't switch to small cars, and the small-car owners already have small cars, so a carbon tax won't do much good—or so the thinking goes.

People—and even cars—are far more complicated. There are a hundred types of cars and a hundred million types of people. Think about an election with two candidates. The polls tell us that 40 percent of voters favor Sue Spender and 50 percent favor Tom Taxer, with 10 percent undecided. Will one bad headline for Taxer have no effect, because people are either for him or against him? That's probably true for 70 percent of the voters. Their minds are made up, and it would take a lot to change them.

But election strategies are all about shifting the fence-sitters, and, invariably, about 10 percent of voters are on the fence—undecided—or extremely close to the fence. For them, little things can make the difference. And notice that once the bad headline shifts the fence-sitters to one side, a new group of fence-sitters climbs on. A new poll might say that 45 percent favor Spender, and 45 percent favor Taxer, and there are still 10 percent on the fence.

The same is true for consumers. On every energy decision—whether to buy a smaller car or a better furnace—most people are firmly in one camp or the other. They already have a smaller car, or they definitely don't want one.

But it's wrong to think of people as coming in just two types. Even if a lot are in one camp and a lot in the other, you always find a good number sitting on the fence. These are the people who respond to the first small change in fuel price. And once they respond and move off the fence to the low-energy camp, a group of people who use more energy move onto the fence, ready for the next price increase to shift them.

Because we face thousands of energy choices, most of us end up on the fence for at least some choices. And if I'm not on the fence now, I may well be in five years, when I need a new car anyway.

Should I drive to the store or walk? It depends on the weather, which is sometimes borderline, so I'm on the fence. Should I turn off more lights or buy more compact fluorescents or check the air pressure in my tires? With higher energy prices, I will think about all this a bit more and make some of these choices differently. Human psychology is not often black or white; in fact, it's tremendously variable. Changing the price of carbon shifts the weights on every decision, and choices that are at a tipping point will tip away from carbon.

The power of the untax is that it shifts the weight on so many billions of choices that it gets maximum bang for the buck. The beauty of the untax is that it shifts only fence-sitters or those close by. These are the people who are bothered least by making a change. So a carbon untax (or a carbon tax) makes all the changes that bother people the least. Those who really don't want to change don't have to. If they are big energy users, the carbon untax charges them, and if they use only a little, the untax rewards them.

Is the Untax Good for Alternative Energy?

As the OPEC crisis demonstrated, the main response to higher oil prices is conservation. During the crisis, non-OPEC supply increased a bit, but demand dropped by about ten times as much. The point to understand about the untax, or any type of energy-price increase, is that it is not aimed solely at conservation. It induces more conservation only when conservation is easier and cheaper than the alternatives.

The untax targets all nonfossil fuels just as strongly as it targets conservation. In fact it also targets all innovations and inventions for new types of conservation and new sources of alternative energy. No regulatory policy could do that. So even if you don't believe conservation is possible, the untax still does the job. This is important, because in the long run, the world needs new technology. The untax will encourage all possible new technologies equally and make sure we get the cheapest one.



An untax rewards not only conservation, but also alternative energy production, and all types of innovation. In fact, it creates a level playing field for all alternatives, present and future, to fossil fuel. But only the cheapest approaches will win out.

A carbon tax derives its power from its breadth. It affects every energy decision, something no other policy can accomplish. It doesn't alter most energy choices, those decisions near a tipping point that are sensitive to a change in cost. That's how a small push has a large effect.

Some say that taxes and untaxes are so weak that people will ignore them. Considering that "no new taxes" is the most potent of all political slogans, it seems odd to think that people would ignore taxes, and in fact history shows they do not. OPEC's "tax" caused great outcry, and, unsurprisingly, the historical record shows a massive and permanent change in the world's use of fossil fuel. Never underestimate the power of tax avoidance.