A Citizens' Approach to Carbon Equity: Voting on Rebates and Collective Investments

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Climate policy activists are deeply divided about what to do with carbon revenues generated from either a carbon tax or the auction of carbon permits. One camp prefers to return the money to the public and the other side wants to dedicate it to green investments. Both claim that their approach is more equitable and likely to win wide acceptance, but disputes of this sort can undercut progress toward any limits on carbon emissions.

This dispute is currently playing out in the state of Washington. One alliance of green groups has placed an initiative on the ballot for the fall of 2016 that would impose taxes on certain carbon-intensive activities and devote the revenue primarily to tax offsets. That initiative is opposed by a second coalition, which is getting ready to submit its own next year. Theirs would also include a carbon tax, but would earmark the revenues raised by that tax for public investment and distributions to community organizations.

I have long been an advocate of the rebate approach, because carbon taxes or permit revenues are effectively sales taxes whose harmful effects on low and moderate-income people need to be counteracted. The macroeconomic drag of a massive fossil fuel tax is best offset by returning the revenues to consumers in ways that give those with more modest incomes a greater rebate. Moreover, I believe that core carbon pricing measures should be kept separate from controversial questions about the overall size and scope of public spending, and simply rebating the revenues helps to avoid such controversies. Nevertheless, I do recognize at least one argument that pulls in the opposite direction: Investments in public services like transportation and energy can help people sustain living standards even as energy prices rise, and public investments can often meet household needs more efficiently than fragmented private solutions. If it makes sense to expand mass transit, for example, many households would benefit if their rebates were reduced somewhat and the extra revenues used to improve such transportation.

Ideally, carbon revenues should just be rebated to citizens, and government would allocate public funds separately to pay for important transportation and energy projects. Households would receive their rebates and, at a different time and place, voters would express preferences for tax and spending policies that could finance green investments. In the real world, however, possibilities for good policy initiatives may be limited, so it might be far easier to combine a carbon tax or fee with commitments to fund environmentally friendly investments.

How, then, to design a package that combines wise collective investments with rebates that are economically fair and stimulate the economy to counteract any negative effects from taxing carbon? In this paper I propose a way for citizens to design the combination democratically, rather than just have policy specialists impose a design.

A Plan to Maximize Citizen Choice

The underlying principle remains "pay it back" – to mitigate climate change, citizens are asked to support a policy that requires them to pay much higher prices for fossil fuel energy to mitigate climate change, but the price increases will generate revenues that go back to citizens rather than into the pockets of energy companies or the governments of countries that export oil. But the repayments to the public can take various forms: cash, subsidies for climate-friendly services, or investments to expand the range and quality of such services over time. For instance, the extra money collected from auto drivers at the gas pump could be returned to consumers as cash rebates or in the form of subsidies for existing transit services or to fund investments in more convenient mass transit opportunities. In short, people can be compensated for paying higher energy prices with money in their pockets or by giving them new individual consumption options or improved access to collective consumption goods like mass transit.

What is the "right" mix of individual and shared options? I propose that the mix be democratically chosen by the people themselves. At regular intervals, the public would vote on the mix they prefer and carbon revenues would be allocated according to the average of the percentages people assign to various options. If the average choice is for 90% of revenues to be rebated in cash, this will be allocation until the next scheduled vote. In this way, carbon revenues will be allocated – and perhaps reallocated over time – toward a mix of public projects and rebates to individuals. The public will retain maximal control over the size of these allocations.

For such a plan to work, a number of operational details have to be worked out:

- **The number and types of options:** At a minimum there could be only two, rebates and investments. This is procedurally straightforward, but might be perceived as giving the public too little control over the use of funds not directly rebated to individuals. In practice, non-rebated funds could be invested in various projects, ranging from transportation improvements to upgrades in the electric grid. Or people's use of already existing services could be subsidized. Offering two or three options in addition to cash rebates might convey a sense that there are alternative forms of useful collective consumption citizens could choose.

- **The frequency of voting:** Votes scheduled frequently, for instance annually, might reinforce the perception of democratic control, but could also prove unnecessarily expensive and likely to produce on and off funding for public projects. Greater intervals between votes could encourage more consistency and long-term planning.

- **Limits on immediate reallocations?** Voting could set allocation rules de novo in each cycle, but there could also be limits on reallocations. For instance, changes in allocations could be limited in any one cycle to no more than a certain percent (5% or 10%) of the previous share. The goal would be to prevent large swings in allocations due to temporary shifts in public opinion at the time of the election. Only if a shift in opinion persists over several election cycles would a radical alteration in allocations take place. A drawback of this approach is that the first election becomes especially important, because it sets a baseline, but that election would happen when people are least familiar with the choices to be made. If limits on sudden reallocations are not considered a good idea, then some of the same benefits can come from making elections less frequent.

- **Transparent audits:** If spending on energy, transportation or other such services is to be credible, the public needs independent, objective monitoring of the programs funded by carbon revenues. Auditors would need to assure citizens that all funds are fully accounted for and no private enrichment is

> occurring. In addition, auditors would need to determine that funds are being spent efficiently on effective programs – and consider whether new investments in services are achieving an equitable outcome, actually offsetting the higher energy prices people have to pay.

Once again, since carbon pricing functions in practice as the equivalent of a sales tax, the immediate hit is hardest on people with low or modest incomes. Rebates to everyone correct for that unfair impact, and any allocations away from rebates to fund public provision of services should also produce results that helps low and moderate-income people the most. Or perhaps, extra help should go to people who are hardest hit by higher energy prices, such as those whose livelihoods or residential locations require them to drive more.

The only way that audits can consider all of the dimensions that go into equitable use of carbon revenues is if those revenues are kept apart from general government budgets. That way, auditors would be able to produce regular reports on carbon-funded projects, to be made available prior to scheduled votes on possible reallocations.

The plan I have just described is meant to apply at the federal level, for the entire United States. But a workable citizen choice plan could allow people in each state to hold their own votes on how to allocate and periodically reallocate carbon revenues returned to each state according to its population size. In this variant, projects would be administered at the state level, so that, say, Kentucky's voters would vote on how to allocate revenues for rebates and/or public projects in their own state. There would have to be some nationwide rules because the carbon revenues would be collected nationwide, but auditing could be conducted at either the state or federal level. Giving each state some independent say in this fashion could lead to greater public acceptance. However, the state by state approach would also make it more difficult to fund projects like improvements in the electrical grid that necessarily cross state borders.

Why Not Just Earmark Carbon Revenues for Green Investments?

An obvious alternative to a plan such as the one I've described is to simply devote some fixed proportion of carbon revenues to an investment program, but I see two problems with this approach. Proponents presume that carbon revenues slated for green investments would be added on to other government investments in good projects. But of course it is difficult to ensure that this would happen, because various pots of revenue are fungible. In practice, public officials would almost certainly shift at least some of the new carbon funding away from its earmarked uses to cover regular government expenses. Officials have strong incentives to do this, because they would gain new general budget funds to allocate as they choose.

There is no foolproof mechanism to ensure that budget-shifting does not occur. The only recourse is to put a system in place that can respond to shifting by altering the amount of earmarking. In a way, regular votes to possibly reallocate the uses of carbon revenues can serve this purpose – because if audits show that budget-shifting is happening, citizens might well conclude that it would be better to allocate a higher share of revenues to individual cash rebates rather than try to earmark them for public investments.

Why Citizen Choice is Worth Considering

My proposal is a concept that, if adopted, would need many specifics to make it fully workable. Some may ask: why go to all this trouble? Why not just rebate all the carbon revenues to each person equally – an approach which will tend to deliver the most money to lower-income people who would be hardest hit by higher energy prices?

My response starts by pointing out that simply asserting the superiority of revenue rebates is not likely to neutralize opposition from important environmentalists who insist that revenues should go, at least in part, to important public green investments. Endless arguments among supporters of policies to mitigate climate change undercut momentum to act, so finding ways to forge compromises among supporters of carbon pricing is important.

In addition, although the case for rebates is compelling, particularly in a time of rising income inequalities, I recognize that devoting some share of carbon revenues to fund public needs can also help people sustain their standards of living during the transition to decarbonized economy. Crucially, however, programs touted as such public investments must produce truly equality enhancing results – both actually and in public perception. Otherwise, citizens will be disillusioned about how funds are spent, even as they must pay higher prices for energy.

If supporters of rebates can accept some of the logic behind allocating funds to public investments, then the proponents of investments should also recognize that even the best-designed and best-intentioned public programs can never address all of the varied needs individuals and families experience – and never correct for all effects of higher energy prices that people in different circumstances will face. Rebates allow individuals to adjust in their own ways, to sustain their standards of living by making climate-friendly choices that fit their own circumstances and preferences.

My plan to let citizens make choices about allocations between rebates and public projects rests on a philosophy of climate policy that activists will have to embrace if they want to build broad public understanding and support for measures to curtail carbon emissions. Idealistic or scientific appeals will not alone suffice, because the economic fortunes of working and middle-class Americans have been steadily eroded in recent decades. People need to be protected from further blows to their income and living standards. That cannot be an afterthought.

Of course, climate change, if unchecked, will devastate the most vulnerable communities here and around the world, and this is an important reason for taking mitigating steps. But it is politically and morally unacceptable for climate reformers to downplay the reality that most households would be vulnerable to rapidly rising energy prices propelled by any new carbon pricing scheme. Carbon pricing policies must include, from the start, plans for the equitable distribution of revenues. To that end, good intentions from experts are not likely to be enough to build public faith. A better way to proceed is to let all citizens know that revenue uses will include rebates as well as public investments – and that the public will have regular opportunities to audit investment programs and to vote periodically to shift carbon revenue allocations in ways acceptable to the majority. This approach could spread benefits and build public faith for the long haul.

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