U.S. Climate Policy Driving Foreign Policy:

Climate policy recommendations – Updated October 20, 2021

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As Congress debates climate provisions in the reconciliation package, the critical benefits of both domestic and international climate action are on the table. The United States has a unique opportunity to enlist other nations in effective climate action by adopting a strong climate policy at home. This double play of domestic policy enabling U.S. international climate leadership is a powerful way for the U.S. to return to the global stage and help meet the United Nations' target for 2050 net-zero emissions.

Domestic policy. President Biden has elevated climate change to the top of his agenda and pledged that the U.S. will be net-zero by 2050. A crucial step in achieving this goal is for Congress to pass a major climate bill. Carbon pricing is the single most effective means of reducing carbon emissions and has support on both sides of the aisle. It should therefore be an essential component of a comprehensive domestic climate policy. The recommended tax will start at $25/metric ton of carbon or carbon equivalent, increasing each year thereafter for ten years by $10/metric ton to reach $125/metric ton. This method of repricing carbon upward can reduce domestic carbon emissions by 50% within ten years, as highlighted in our full policy report. Simultaneously, it will energize our economy by creating millions of jobs, provide health benefits through cleaner air, and ensure a fair energy transition for all. A carbon tax and dividend bill will increase the price of all carbon fuels and carbon-based goods over time, causing consumers and businesses to switch to lower-carbon alternatives. The Treasury collects the tax at the source of energy production (well or mine-head) and returns the revenue to all adult citizens in equal quarterly refunds.

The policy is fair. Wealthy households consume the most carbon-intensive goods, thereby dispersing the most earth-warming gases into the air. Thus, they would pay the largest part of the carbon tax bill. Because low-income households spend less on carbon fuel and goods, they pay less carbon taxes. Since dividends are the per person average of the collected carbon taxes, lower-income households receive dividends that exceed tax payments, providing cash benefits each quarter. Thus, they gain cash because they pollute less. In fact, around 70% of the population will receive enough in quarterly dividends to offset their increased costs, thereby ensuring that the cost of decarbonization does not fall on the poor and working classes. Part of

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the revenue from the carbon fee could also support communities dependent on fossil fuel industries to transition to robust and diversified clean economies.

As the country battles the economic fallout of Covid-19, the additional income would be a welcome aid to households. Raising the price of carbon has proven highly effective in reducing emissions, which is why over 40 countries, including major U.S. trading partners, have put a price on carbon. Its singular advantage is that it uses the myriad skills and knowledge of industry, including the talents of entrepreneurs, engineers, scientists, investors, and others, to choose the most cost-efficient and innovative routes to a carbon-free economy. Of all plans, this has the best chance to gain bipartisan support. Conservatives like it because it uses the free market to unleash American innovation and keeps government small, while liberals like it because it benefits low-income households by improving their net income.

Perhaps most importantly, the plan can contribute to restoring public trust. It is easy to understand, transparent, and designed to be grasped as a single idea – price carbon out of the market and press other countries to do the same. As the energy transition accelerates and dividends are received public confidence in government will grow.

International Action. Action by all countries is needed to forestall climate change. Moreover, strong climate legislation will not pass Congress without assurance that other countries are also putting their shoulders to the climate wheel. Current carbon reduction commitments under the Paris Agreement do not come close to limiting the increase in global average temperature to 2°C, or preferably 1.5°C, to avoid dire consequences. To accomplish this, the U.S., China, and the E.U. must work together to forge a coalition or Compact of countries that pledge greater emissions reductions. Most of the world's largest economies, including China, already have some form of carbon pricing or are implementing such measures, and would likely welcome bold U.S. action. Further, the U.S. has shared interests throughout the Americas, and one of its largest trading partners, Canada, has already implemented a carbon tax.

Members of this global Climate Compact would agree to raise their carbon tax rate or lower their carbon cap and place a penalty fee on imported goods from non-members. Carbon prices will increase production costs, however, penalty fees on imports from countries outside the Compact will level the playing field and prevent "free riding" by nonmembers. Based on these incentives, in time, most major countries would join the Compact. Nobel Laureate Professor William Nordhaus and others argue this is the most effective way to encourage countries to rapidly decarbonize. And because the U.S. economy is more energy efficient than most, it gains comparative advantage by increasing the cost of carbon-based fuels. Furthermore, if designed and adopted as a Carbon Surcharge fee, the penalty fee would unite countries with different responsibilities and needs for a global energy transition. The Carbon Surcharge would place a fee on all goods imported from nonmember countries, which would then finance assistance for energy transitions and resilience in Developing Countries. This surcharge protects the competitiveness of exports from Compact Countries while assisting developing countries with annual revenues estimated between $120 and $225 billion – more than what has been promised, but not delivered, through the Green Climate Fund.

This is the time for the U.S. to commit to domestic carbon pricing and facilitate collaborative leadership among carbon reducing countries. As China produces 30% of global emissions, global climate mitigation success depends on a partnership between China and America to create a global coalition of emission reducers. Although the U.S. and China will differ sharply on human rights and national security issues, they must be in lockstep leading the world to climate health.

U.S. climate leadership is necessary, but other countries will be skeptical of our commitment and ability to foster systemic change without durable and binding domestic climate legislation. Aggressive U.S. climate action will give the U.S. the credibility in its foreign policy to a) rebuild security and trade alliances; b) foster collaboration to manage and protect our global commons, such as oceans, freshwater systems and biodiversity; and c) energize industry and increase U.S. research and development to keep pace with surging Chinese technological advancement.

International trade rules that promote sustainability and openness are important. As countries raise their climate ambitions, they will want a level playing field for their exports. Domestic and international climate leadership go hand in hand with the reforming of trade rules. Rather than penalizing countries that strive to reduce their emissions, these rules should promote a more sustainable international trade regime. The E.U. has announced its plan to adopt carbon border adjustments to protect the competitiveness of its industries and press other countries to increase their climate ambition. President Biden and members of Congress have endorsed a similar measure. As carbon pricing initiatives – and border carbon adjustments – continue to expand, a Climate Compact becomes a superior method of leveling the playing field by using easy-to-administer, universal single rate fees. Western leadership is vital to defend and maintain fair and open rules for global trade. In fact, the concept of a Climate Compact already has the support of leaders such as Olaf Scholz, Germany's finance minister and Angela Merkel's likely successor.

The Necessity of a Bold Plan. The pandemic and climate change have demonstrated the need for cooperative international action to surmount global challenges. The failure of the U.S. and its allies to provide leadership and collaborate could lead to both climate catastrophe and the unwinding of the current open and rule-based global trading system. Both domestic and international action are equally important. Domestic climate mitigation action makes global leadership possible, and *vice versa*. This bold plan can restore the U.S. position among the world's leading nations to create a healthy climate and a safer and more just society for all.

This framework builds on previous research and analysis. Please see our climate policy report, *Addressing Climate Change Using a Carbon Tax and Dividend Plan within a Global Compact*, and our recommendations for a *Climate Club and Carbon Surcharge Transfer (Proposal for COP26).*

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