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“Putting a price on carbon” through market-based policies like cap and trade or a carbon tax is the most cost-effective way to reduce greenhouse gas pollution. By raising the price of fossil-fuel energy products — from home energy and gasoline to food and other goods and services with significant energy inputs — these policies would encourage energy conservation, investments in energy efficiency, and the use of clean energy sources. But the higher prices would also squeeze consumers’ budgets. Consumers with low or moderate incomes would feel the squeeze most acutely.

Fortunately, well-designed climate policies can generate enough revenue to fully offset the impact of the higher prices on the most vulnerable households, as well as to cushion the impact for many other households and meet other public needs, such as expanded research on alternative energy technologies. And they can do this without blunting the market “price signal” that is essential for achieving cost-effective emissions reductions.

Using Consumer Refunds to Protect Vulnerable Households

Low-income households spend a larger share of their budgets on necessities like energy than do better-off consumers. They also are the least able to afford new energy-saving vehicles and appliances, and they already face major challenges making ends meet. That is why climate-change legislation should protect low- and moderate-income households against increased poverty and hardship.

An excellent way to do this is by providing these households with direct “energy refunds” to offset the hit that their budgets experience from higher energy-related prices. Unlike measures that shield households from facing the higher prices in the first place (such as by holding down increases in their utility bills), direct energy refunds preserve consumers’ incentives to conserve energy and invest in energy efficiency.

Because energy-related products will cost more, households with the flexibility to conserve energy or invest more in energy efficiency will be better off taking these steps than using their energy refund to maintain their old ways of consumption. At the same time, households that cannot easily reduce their energy consumption can use their refund to avoid a reduction in their standard of living.

Refunds can be delivered effectively using existing, proven mechanisms. Eligible working households could receive a refund through a refundable tax credit. Households that do not have to file federal income taxes, including many households with elderly, unemployed, or seriously disabled persons, could receive a refund each month through state Electronic Benefit Transfer (EBT) systems. These are essentially debit card systems that states already use to provide SNAP benefits (food stamps), TANF, and other forms of assistance to low-income families, the

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elderly, and others. In some cases, low-income elderly and disabled beneficiaries of Social Security, Railroad Retirement, or veterans' benefits could receive the refund as a supplement to those benefits.

Consumer Protection in the 2009 House Climate Bill

The cap-and-trade bill the House of Representatives passed in 2009 (H.R. 2454) included important provisions to offset higher energy prices for all households and to help ensure that the bill did not make poor families poorer or push more people into poverty. Legislation to accomplish similar goals was introduced in draft form in the Senate but went no further.

The House bill would have provided all eligible low-income households with a monthly energy refund delivered via EBT. To pay for these refunds, the legislation reserved the proceeds from the sale of 15 percent of the allowances that emissions-producing firms would have been required to hold. The size of the refund would have varied with family size; it was designed to offset the average increase in energy-related costs for a household with an income equal to 150 percent of the poverty line.

The House bill would also have helped all consumers, regardless of income, by giving free emissions allowances to retail electric and gas companies, which they would use to provide their customers with relief on their utility bills.

The Congressional Budget Office found that the House bill would fully protect the average household in the poorest 20 percent of the population from financial loss due to increased energy-related prices. This basic approach of providing low-income relief through a refund delivered through existing electronic payment mechanisms could easily be adapted to a carbon tax.

Providing Consumer Refunds Further up the Income Scale

Policymakers have to decide the amount of consumer protection they want to provide to households in particular income groups and how far up the income scale they want to provide such assistance.

If they want to expand consumer assistance to moderate- and middle-income households, refundable income tax credits or supplements to Social Security and related federal benefits are the best delivery mechanisms. But because substantial numbers of low-income households could be left out, policymakers should retain the EBT delivery mechanism to serve those households under a carbon-pricing policy.

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