percentage-point retail sales tax reduction, reduce certain manufacturing and processing business taxes, and increase certain tax credits and rebates. Should this measure be enacted into law? Yes [ ] No [ ] . Feedback welcome on the blog and/or on Facebook and Twitter!

* **Readings:** Here are the materials from yesterday's meeting of Governor Inslee's Carbon Emission Reduction Taskforce. (More on this next week!) Also, here's an hour-long Skype discussion of carbon taxes with Bob Inglis of the Energy & Enterprise Initiative, former Secretary of State George Shultz, and RFF president Phil Sharp. Also "Carbon tax hasn't harmed B.C. growers, study finds" and two articles on the carbon pricing debacle in Australia: NY Times and New Yorker. Here's Patrick Mazza on "A Washington State climate policy that does the carbon math", and here's Evergreen economics professor Peter Dorman's blog series on "The Road from Carbonville".

Stay tuned for more news next week, but this week we're closing with...

* **An open letter to the Western States Petroleum Association.** In the spring we published an open letter to Governor Inslee, and now it's the Western States Petroleum Association's turn. If we were invited to address their company executives and employees, here's what we'd say:

Thanks for the invitation to come and speak with you. Too much demonization (of fossil fuel companies on the one hand, and of climate policies on the other) makes it hard to have open lines of communication, so I appreciate your kindness.

Having said that, let's get down to business. I've got good news and bad news. The bad news is that you're in the carbon business, and it turns out that carbon emissions are not free: global warming, ocean acidification, etc. As a result your industry is the target of a host of low-carbon policy proposals, including market-based policies (carbon taxes and cap-and-trade systems) as well as regulatory approaches like California's Low Carbon Fuel Standard, which may be coming to Washington State.

The good news is that there's an opportunity to address this issue in a way that will not fundamentally change your business for decades to come.

That doesn't mean that you have nothing to worry about in the decades ahead. You will face (or at least I hope you will face!) increased competition from electric cars, from biofuels, from natural gas, and from efficiency improvements. But if you play your cards right you will be able to face those competitors as Adam Smith intended, on a level playing field, rather than with one hand tied behind your back because of climate policy.

My underlying reasoning here is based on one simple fact: Yes, you are in the carbon business, *but you're lucky enough to be in the high-value-added carbon business*.

Consider, for example, a BC-style carbon tax of $30 per ton of CO_2. That kind of policy would increase the price of gasoline and diesel by about 30 cents a gallon. I'm sure that you'd rather not have that tax, but let's put it in perspective. Thirty cents a gallon is less than 10% of the current price of gasoline, and other jurisdictions (Europe, Canada, etc.) have fuel taxes that are much higher than ours without destroying demand for gasoline and diesel. The bottom line is that a BC-style carbon tax of $30 per ton of CO_2 will not fundamentally change your business.

The same cannot be said for coal. That's because *coal is a low-value-added carbon business*. A carbon tax of $30 per ton of CO_2 would roughly double the cost of coal. (If you want the math: A million BTUs of coal costs about $30 and produces about one metric ton of carbon dioxide. A million BTUs also equals about 100 kWh of electricity, so a $30 carbon tax works out to about 3 cents per kWh of coal-fired power.) Coal would have an even harder time competing with alternatives like natural gas, which would see a price increase of only 1.5 cents per kWh, and renewables, which would see little to no price increase.

In short, the so-called "war on coal" is an inevitable result of the fundamental facts that coal produces a lot of carbon dioxide and generates relatively little economic value-added.

The risk I see for your business is that you could get caught in the crossfire. Some people look atemissions in Washington State, see that petroleum-based transportation fuels account for the lion's share of emissions, and conclude that we have to focus on transportation fuels. This is wrong on the face of it: the best way to diet might be to eat less dessert even if most of your calories come from main dishes. But it's even more wrong when you consider national and international perspectives. Transportation accounts for about 1/2 of Washington State greenhouse gas emissions, about 1/4 of national greenhouse gas emissions and about 1/8 of global greenhouse gas emissions. The global climate challenge is mostly about coal and electricity generation, not about petroleum or transportation fuels.

Nonetheless, many people in Washington State want to target transportation fuels. "An extra 30 cents a gallon will only have a small impact on petroleum consumption", they say, and they're probably correct. But instead of following that thought to its economically logical conclusion---which is that the low-hanging fruit is elsewhere---they instead double-down in calling for a Low Carbon Fuel Standard or other policies that specifically target transportation fuels.

These policies pose a serious threat to your industry. The report you commissioned from the Boston Consulting Group estimated compliance costs by 2020 of 33-106 cents per gallon for California's Low Carbon Fuel Standard, plus an additional 14-69 cents per gallon to comply with

California's cap-and-trade program. Those numbers look to me to be on the high side, but the underlying point is that there's a serious risk that these types of policies will fundamentally change your business.

Fortunately, there's an easy way out for you: Support smart climate policies, oppose dumb ones, and work to build alliances that will focus on economic efficiency. Some enviros say that you'll never do that, but in fact it's in line with the policy statement on your website: "WSPA supports [properly designed] market based programs as the most cost effective way to reduce carbon emissions."

Let me give you an example of how this could work in Washington State, based on the proposal from our group, CarbonWA.org. The current iteration of our proposal is for a carbon tax starting at $15 per ton of CO_2 in the first year, $25 in the second year, and rising thereafter at 5% per year, up to a maximum of $100 per ton in 2050. We openly acknowledge that this will raise the cost of fossil fuels---again, $25 per ton is about 25 cents per gallon---and it will also raise the cost of refinery operations by 1 or 2 cents per gallon. (That's $70-140 million total for the 7 billion gallons produced by refineries in Washington State.)

That's not the end of the story, though, because our proposal is to take the revenue from the carbon tax and use it to reduce existing taxes. ("Tax bads, not goods.") Most of the revenue will go to reduce the state sales tax by a full percentage point, which will save money for households and businesses. But we also allocate smaller chunks of the revenue to address impacts on low-income households (through the Working Families Rebate) and on manufacturers (by eliminating the B&O business tax for manufacturers). According to the Washington Research Council, your industry paid $105 million in B&O taxes in 2011, including perhaps $60 million in manufacturing B&O taxes, so eliminating the B&O tax for manufacturing is not small potatoes.

A policy like the CarbonWA proposal would also make a Low Carbon Fuel Standard unnecessary, which is great because to the best of my understanding it's a pretty weak policy, producing questionable carbon reductions at relatively high cost. (For example, my calculations suggest that an all-electric Nissan Leafpowered by coal-fired electricity produces more carbon than my 35mpg Honda Fit.) I don't speak for the environmental community, and I certainly don't speak for Governor Inslee, but I think (and I hope!) that you'd find a lot of support for permanently tabling the Low Carbon Fuel Standard in exchange for a BC-style price on carbon. Then, instead of fighting over what to do next, we could instead do what BC does, which is spend their time proselytizing at the national and international level for their terrific revenue-neutral carbon tax. (These national ambitions also provide strong incentives to honor whatever commitments are made: hopes for a national carbon price rest on successful policies at the state level.)

There are of course plenty of details to be worked out, and also fundamental issues of trust, but I'm optimistic that all this could be sorted out with some additional discussion and open lines of communication. And that's why I want to end on the same note on which I started, which is to thank you for inviting me to join you and address your association. If you want to talk more I'm atyoram@carbonwa.org.

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Comments on the letter (or the ballot title, or other developments) are, as always, welcome on the blog!

Cheers,

yoram

Paid For By...

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