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Pax World Investments

Tax Reform? Let's Make It a Carbon Tax

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We often use the term "underwater" to describe money-losing investments in finance. That may not be a euphemism for long. Of the world's 15 largest stock exchanges, all but four are in coastal cities, and all could face the prospect of literally being submerged underwater as sea levels rise. The financial value at risk from climate change is in the trillions of dollars.[1] How many trillions? Anywhere between $2 trillion and $24 trillion, according to a recent analysis in *Nature Climate Change*. Real money, a sum so large that neither major political party can turn a blind eye any longer.[2]

How can we keep our money—and our planet—above water? We need to put a price on carbon emissions.

Climate change is an issue that investors of all ages and demographics are taking very seriously. Investors have a growing list of tools to address climate change, including measuring and reducing the carbon footprints of their portfolios, divesting from fossil fuels, and investing in clean energy and low-carbon solutions providers.

But is it enough? The current pace at which humanity is reducing its impact on climate change is simply too slow to avoid catastrophic impacts—including financial impacts.

A smartly-written carbon tax could give these efforts a strong tailwind. It's a policy proposal that is perhaps not at the top of the current tax-reform agenda in Washington, but ought to be.

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KEY TAKEAWAYS

- The financial value at risk from climate change is in the trillions of dollars.
- Our national and global economies are ready for a low-carbon future—all we need is the incentive to invest in one that a carbon tax provides.
- A carbon tax will send a signal to markets that the way we produce energy now is putting our economies and societies at ever-increasing peril.

[1] The Economist, "The cost in inaction: Recognising the value at risk from climate change," 2015.
[2] Bloomberg View, "A Republican Carbon Tax," February 9, 2017.

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One of the most commonly-accepted principles of economics is that a tax is an efficient way to change the way we use and value things. A carbon tax will send a signal to markets that the way we produce energy now is putting our economies and societies at ever-increasing peril.

What does "peril" mean here? "All along the Eastern Seaboard in the United States, cities, towns—even naval bases—are battling an array of problems caused by increased coastal flooding and encroaching tides."[3] That comes from the CFA Institute, the premiere group that maintains the standards for investment management professionals. Zillow reports that nearly 300 cities could lose at least half their homes, and 36 cities would be gone altogether.[4]

To protect ourselves from this imminent peril, we need a paradigm change for energy, because right now, we get most of it by burning fossil fuels, and that accounts for over two-thirds of global greenhouse gas emissions (GHG). How do we know it works? Some places have already taken action. There are carbon taxes and regulatory caps on GHG in many countries and regions, and in all of them, the benefits of making emissions more expensive have outweighed the costs of the taxes and regulations. Sweden, British Columbia, California, and the northeastern states involved in the Regional Greenhouse Gas Initiative (RGGI) have all maintained respectable economic performance while significantly limiting emissions. In the second three-year period of its existence, RGGI produced a net economic benefit worth $1.3 billion. The economy of British Columbia, after the implementation of a carbon tax, grew faster than those of its neighboring provinces. During the nearly two decades of Sweden's carbon tax, the country's economy grew nearly 60%, while its emissions fell 23%.[5]

There has never been a better time for us to take this step. The costs of renewable energy have fallen rapidly, advancing technologies for batteries and electric vehicles. Wind and onshore solar are already cost-competitive with coal and gas, on a levelized cost of energy basis, and continue to fall.[6] Falling battery prices mean that electric vehicles could constitute over one-third of all new car sales by 2040.[7] Corporate sourcing of renewables could be a significant driver of reduced emissions.[8] And investors, who have at times been slow to recognize environmental and social sources of risk, are now increasingly aware of, and acting on, the risks and opportunities of climate change. Want proof? Check out what Morgan Stanley, Standard & Poors, and Mercer say about it.[9]

And finally, solar power now employs more people in electricity generation in the U.S. than gas, coal, and oil combined, according to Forbes. Rather than pouring more money into an effort to save jobs in coal, an industry that financial markets see as a long-term loser, we could use the revenue from a carbon tax to help provide a just transition for coal miners.

Our national and global economies are ready for a low-carbon future—all we need is the incentive to invest in one that a carbon tax provides.

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[3] CFA Institute, "Rising Sea Levels and a Falling Margin of Safety," October 11, 2016.
[4] Krishna Rao, "Climate Change and Housing: Will a Rising Tide Sink all Homes?," August 2, 2016.
[5] Magdalena Andersson and Isabella Lovin, "Sweden: Decoupling GDP growth from CO_2 emissions is possible," May 22, 2015.
[6] Lazard, "Levelized Cost of Energy Analysis 10.0," December 15, 2016.
[7] Bloomberg New Energy Finance, "Electric vehicles to be 35% of global new car sales by 2040," February 25, 2016.
[8] RE 100, "Annual Report: corporate sourcing of renewables holds key to net-zero emissions economy," January 2017.
[9] Morgan Stanley, "The Investor's Guide to Climate Change," December 11, 2015; Climate Home, "S&P: Banks that ignore climate risk face credit downgrade," June 5, 2016; Mercer, "Investing in a Time of Climate Change," 2015.

We have proven that we can put a price on carbon emissions and still prosper economically. And we have a lot of evidence that the status quo will threaten that prosperity. It's time for a new energy paradigm. The companies that emerge as leaders in our low-carbon, new energy future will be those that recognize that they're in the midst of a transition that no lobbying budget can vanquish, and no "alternative facts" can avoid.

Pax World Management LLC

Pax World Management LLC, investment adviser to Pax World Funds, is a pioneer in the field of sustainable investing. Pax World integrates environmental, social and governance (ESG) research into its investment process to better manage risk and deliver competitive long-term investment performance. For over 45 years, Pax World has made it possible for investors to align their investments with their values and have a positive social and environmental impact. Today, its platform of sustainable investing solutions includes a family of mutual funds, as well as separately managed accounts.

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