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We Still Need a Carbon Tax, Pipeline or Not

THE CANADIAN TAR SANDS DILEMMA

by Joseph F. Keefe, President & CEO, Pax World Management LLC

President Obama has put climate change back on the public policy agenda. Well, Executive Branch policy at least. Congress will of course do nothing, in large measure because one bloc (which happens to be one of our two great political parties) denies the science and receives heavy financial backing from the very special interest that stands to benefit most from doing nothing—the fossil-fuel industry (coal, oil, gas and power companies).

Meanwhile, there is a rough consensus in the scientific community that:

- The upper limit for CO2 in the atmosphere, beyond which the impacts are more likely to be catastrophic, is 350 parts per million (ppm), whereas we are currently approaching 400ppm.
- Any additional warming above 2° C is likely to be disastrous—and we are almost halfway there.
- The known coal, oil and gas reserves of the fossil-fuel companies greatly exceed the carbon we can safely release into the atmosphere. Much of this is in the Canadian tar sands, which emit significantly higher greenhouse gases than other types of oil—which is why NASA scientist James Hansen has warned that building the Keystone XL pipeline would be "game over for the planet."

Climate change is largely the result of one very powerful special interest, the fossil-fuel industry, getting a special pollution break—essentially a subsidy—that enables them to dump their carbon pollution into the atmosphere for free. With the massive financial clout they derive from these subsidized profits, they have been able to capture the very public officials who are supposed to be regulating them but who are instead in their thralls.

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Joseph F. Keefe is President & Chief Executive Officer of Pax World Funds, which launched the nation's first socially responsible mutual fund in 1971 and today is a recognized leader in the field of Sustainable Investing—the full integration of environmental, social and governance factors (ESG) into investment analysis and decision making. Pax World offers a family of mutual funds, multi-manager asset allocation funds, an exchange traded fund (ETF) and separately managed accounts for institutional investors. Mr. Keefe was named by *Ethisphere Magazine* as one of the "100 Most Influential People in Business Ethics" for 2007 and 2008.

KEY TAKEAWAYS

- Climate change is largely the result of one very powerful special interest, the fossil-fuel industry, getting a special pollution break—essentially a subsidy—that enables them to dump their carbon pollution into the atmosphere for free.
- Any truly effective strategy to combat climate change would require two fundamental elements: first, putting a price on carbon so that polluting the atmosphere is no longer free; and second, keeping a significant portion of remaining fossil-fuel reserves in the ground rather than burning them.
- A well-crafted carbon tax will put a price on carbon so that clean energy can effectively compete, and will generate significant revenues, a portion of which can be assigned or recycled right back to the energy companies in the form of transition subsidies that will enable them to convert over to sustainable energy.

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It is easy to understand why the fossil-fuel industry spends so much money on lobbying and campaign donations. Any truly effective strategy to combat climate change would require two fundamental elements: first, putting a price on carbon so that polluting the atmosphere is no longer free; and second, keeping a significant portion of remaining fossil-fuel reserves in the ground rather than burning them. In each instance, fossil-fuel industry profits would be greatly reduced. So, with Congress firmly in their grasp, they have remained implacably opposed to any meaningful progress. This is the great dilemma of climate change.

That dilemma is about to be magnified as we approach a decision on the Keystone XL pipeline. Although the environmental community is urging President Obama to cancel the pipeline, the president still talks about an "all of the above" energy strategy, which could very well mean approving the pipeline. This outcome may be even more likely following a recent State Department draft report finding little or no environmental costs associated with the pipeline, as ridiculous as that may sound.

One problem is that the fossil-fuel industry is currently incented to move the dirty crude from the Canadian tar sands to market one way or the other. If the Keystone pipeline isn't built, they will find another way—that, at least, is the State Department's contention. If this is the case, then pipeline or no pipeline, perhaps we should be considering other ways to prevent the oil from coming to market.

This is where a carbon tax comes in.

The fact remains that preventing catastrophic climate change still requires that we (1) put a price on carbon, and (2) prevent the fossil-fuel companies from harvesting most of the additional reserves buried beneath the earth. A carbon tax is the surest way to accomplish both objectives.

A carbon tax is the only step that truly enlists markets in the fight against climate change. As fossil-fuel companies are forced to pay for the damage their carbon is doing to the planet, the price of their products would rise. As fuel prices rise, consumers would be incented to use less, conserve more and switch to zero-carbon alternatives. Non-polluting, renewable energy sources would become more competitive as the playing field is leveled. We have already begun to see marginally positive results in places like British Columbia and Ireland, where carbon levies have been implemented.

But how would we overcome the implacable opposition of the fossil-fuel industry and its minions in Congress, including a Republican House that is now seemingly opposed to all forms of taxation under any circumstances?

Logically, there are only two options:

(a) the fossil-fuel industry and its allies would have to be defeated on the political and policy front; or

(b) they would have to be persuaded to join the effort rather than resisting it.

Despite the best efforts of environmentalists, scientists and other reformers who have worked on this issue for so long, prevailing in a head-to-head contest against the fossil-fuel lobby in sufficient time to prevent irreversible climate damage is highly unlikely. Given our current political divide, our campaign finance system, our evolutionary bias in favor of focusing on immediate rather than long-term threats and what would be required to marshal public opinion—let alone create a movement—in sufficient time to make a difference, it is unrealistic to think that climate change can be successfully tackled with the fossil-fuel interests aligned in steadfast opposition. When it comes to climate, the race is against time, and the fossil-fuel industry will simply dump too much carbon pollution into the atmosphere before they can ever be successfully subdued.

Which brings us to the second option—persuading the fossil-fuel industry to switch sides. Believe it or not, this is actually the more realistic alternative. Exxon Mobil has already tepidly endorsed a carbon tax—at least as preferable to cap and trade. I believe other energy companies could be persuaded as well, and that this is where we should be focusing our efforts—on turning the biggest opponents of a sane climate policy into its biggest proponents.

Needless to say, the fossil-fuel industry won't be turned simply by reasoned argument. Their business model is inextricably linked to converting every asset they own into bottom-line profit. They can be expected to behave the way corporations ordinarily behave, putting the short-term financial interests of shareholders and management insiders ahead of the long-term interests of society at large. Leaving carbon in the ground is leaving money on the table as far as the fossil-fuel industry is concerned. They are not going to just walk away from monetizing those assets.

No, what I mean by persuading the fossil-fuel industry to join the cause is to bribe them. That may sound facetious, but what I mean is that we will need to pay them to leave the carbon in the ground and invest in clean energy instead. We will need to make it more profitable for them to produce clean energy than to produce dirty energy.

This won't be a cakewalk, but it may be easier than we think. Once again, a well-crafted carbon tax is the key. Not only will it put a price on carbon so that clean energy can effectively compete, but a carbon tax will also generate significant revenues, a portion of which can be assigned or recycled right back to the energy companies in the form of transition subsidies that will enable them to convert over to sustainable energy. These transition subsidies could include expanded investment tax credits, low-interest loans, price supports, and so forth—and should obviously replace current fossil-fuel subsidies. But the amount transferred would have to be meaningful and would have to approach or approximate the profits the energy companies forego by leaving the fossil fuels in the ground.

We will need to abandon the notion, advocated by some well-meaning carbon tax proponents to make the idea more palatable, that a carbon tax should be revenue neutral. It shouldn't be. Similarly, we should resist efforts to enlist carbon tax revenues to address a wish list of other social objectives. While assigning some portion to deficit reduction is undoubtedly warranted, the revenues from carbon levies should be primarily directed at hastening the transition from carbon-based energy to clean energy, pure and simple.

Some will complain that the fossil-fuel industry has been subsidized long enough and will be skeptical of a plan that further bolsters the fortunes of the perceived bad guys. But not all the subsidies and incentives would go to fossil-fuel companies—many renewable energy developers, for example, may be in other sectors such as industrials or materials and are not, strictly speaking, energy companies. Moreover, the fossil-fuel companies were in the energy business long before we knew their products contributed to global warming; they didn't set out to warm the planet. Plus, their behavior is probably rational from a short-term, profit-driven perspective. What we need to do is alter their behavior, which requires that we redraw markets in a way that allows long-term value to trump short-term profit. A carbon tax is the most effective tool to help us accomplish this.

The Canadian tar sands are the perfect laboratory for this experiment. We know roughly how much oil is buried beneath the tar sands and the fossil-fuel companies know what it would cost to extract, ship, refine and sell it. Estimating its market value shouldn't be overly difficult. Moreover, Canada is a friend and ally. It is also a country that has much more to gain by being part of the solution rather than the problem when it comes to climate change. Although neither Canada nor the fossil-fuel companies can be expected to walk away from the wealth represented by the tar sands, we have before us the perfect opportunity to see whether we cannot devise another way for them to achieve their financial goals without jeopardizing the climate.

What we desperately need is a strategy to transform the energy companies of today into the energy companies of tomorrow. To do this, we need carrots as well as sticks; there have to be appropriate price signals and market incentives. Although many of these companies are currently in the fossil-fuel business, that doesn't mean they can't switch over to the clean energy business. To the contrary, success in the fight against climate change requires that we help them do precisely that. This, in turn, will require a carbon tax—and one where the revenue generated by the tax is intelligently deployed.

The Canadian tar sands represent a do-or-die moment. Regardless of what decision is made on the Keystone XL pipeline, President Obama and other policy makers should be engaging with the energy companies and the Canadian government to build support for a well-crafted carbon tax—in both countries—that creates incentives to keep the oil buried beneath the ground while expediting the transition from an industrial-age economy powered by fossil fuels to a sustainable economy powered by clean, renewable energy.

Pax World Management LLC

30 Penhallow Street,
Suite 400
Portsmouth NH 03801
800.372.7827
www.paxworld.com

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