BUSINESS

Assessing the use of pollution taxes

NEW HAVEN, CONN.

Nobel laureate looks at where his ideas work and where they don't

BY CORAL DAVENPORT

William D. Nordhaus, the Yale economist who shared this year's Nobel in economic science, has pointed words for some of the experiments so far with his theories on taxing polluters to fight climate change.

"It was a catastrophic failure in the European Union," he said last week, just days after not only being awarded the Nobel, but also seeing his life's work embraced in a landmark United Nations assessment of the global threat of climate change.

That document, approved by more than 180 nations, described Professor Nordhaus's ideas as essential for slowing the carbon dioxide emissions that are rapidly warming the atmosphere.

But in other places around the world — notably, parts of Canada and South Korea — politicians have adapted the idea in ways that not only show signs of working, but that also reframe it not as a tax but as a financial windfall for taxpayers. Other governments, including those of China and some individual states in the United States, are also testing different ways to force companies to pay to pollute.

In short, the world is becoming a laboratory for theories that Professor Nordhaus developed decades ago, when global warming was an abstract future threat.

By contrast, last week's United Nations report amounts to a stark warning of immediate risk.

The report, from the Intergovernmental Panel on Climate Change, said that if greenhouse gas emissions continued unabated, the atmosphere would warm up to 1.5 degrees Celsius, or 2.7 degrees Fahrenheit, by 2040, leading to irrevocable damage including severe food shortages, coastal inundations and the displacement of tens of millions of people as soon as 2040. If the planet keeps warming to 2 degrees Celsius, or 3.6 degrees Fahrenheit, the effects could include devastating floods and droughts and the permanent loss of the world's coral reefs.

The Nobel, which Professor Nordhaus shared with the New York University economist Paul M. Romer, was widely perceived as a rebuke to President Trump, who has called climate change a hoax and sought to roll back the United States' existing climate change policies. It is also seen as a broader challenge to powerful Republican political voices in the United States, among them the libertarian billionaire brothers Charles and David Koch and the anti-tax activist Grover Norquist, who have attacked lawmakers who support a carbon tax, making it among the most volatile ideas in American politics.

MONICA JORGE FOR THE NEW YORK TIMES

William D. Nordhaus, who shared this year's Nobel in economic science. "What is toxic or opposed in one generation gradually becomes accepted in the next," he said.

On Wednesday, Professor Nordhaus discussed his carbon pricing theories and the political landscape. The exchanges have been edited and trimmed.

Why is carbon pricing seen as political poison in the United States?

It's been caught up in the politics, and it just happens that this particular policy is one that has faced the wrath of a whole group of thinkers. Grover Norquist, energy companies, it's the Koch brothers and their foundations, it's people using fair tactics and foul tactics — it's been caught up as one of the issues in the Great Divide.

This anti-tax movement has been so powerful and so harmful in the United States. There have been a large number of conservative economists in the United States who have endorsed the idea of a carbon tax.

Where has carbon pricing been successful? Where has it failed?

We learned with the European Union that once you go beyond the simple, idealized version of carbon prices and into implementation, it's a very different thing. One of the things we found out: One of the problems with cap and trade [a system in which governments place a cap on countries' carbon-dioxide pollution and companies then pay for, and trade, credits that permit them to pollute] is that it is dependent on predicting what future emissions will be. But if those projections are wrong, the system fails.

With the E.U., their projected carbon emissions were high, but the actual carbon emissions were low, and the carbon price fell drastically, from $30 to $40 per ton down to single digits. So the price was so low it did not have an effect in lowering emissions. It was flawed design. If the models had predicted too few emissions, and the price had gone to $1,000 per ton. we would have had a different problem.

The carbon tax has different problems, but not this one. The price of carbon is independent of the amount of emissions.

When I talk to people about how to design a carbon price, I think the model is British Columbia. You raise electricity prices by $100 a year, but then the government gives back a dividend that lowers internet prices by $100 year. In real terms, you're raising the price of carbon goods but lowering the prices of non-carbon-intensive goods.

That's the model of how something like this might work. It would have the right economic effects but politically not be so toxic. The one in British Columbia is not only well designed but has been politically successful.

What went wrong when President Obama tried to implement a carbon price in 2009?

I did not talk to Obama about this directly, but I spoke with many of his advisers over the years.

One of my very, very few disappointments in Obama when he was president is that he did not come out in favor of carbon tax. I'm sure he did the political calculus on this. He should have come out and talked not just about climate change and its dangers but how to use a carbon tax to fix it. He was a great speaker, a great educator but this is one where he let us down, I think.

How do you think a carbon tax could get bipartisan support?

Things change over the long run. What is toxic or opposed in one generation gradually becomes accepted in the next. Social security took a long time. It was opposed for many, many decades but since Reagan it has been widely accepted.

On carbon taxes, people's views have changed from being very hostile, to conservative economists embracing this, to the I.P.C.C. saying, this is the approach.

I have to be hopeful that, if we continue to work on this, the public will get there on the science, and make an exception to the toxicity of taxes. It will help if it's tied to something popular — if, as a result of the revenue from a carbon tax, you get a check in the mail, or it funds health care.

In terms of implementation, it's not much more difficult to implement than a gasoline tax. Gasoline taxes are very easy to implement.

But gasoline taxes are also politically toxic.

Only in this country! In other countries, people are grown-up, and they can live with taxes.

The problem is political, rather than one of economics or feasibility. It's because it's used as a weapon. At some point, I'm hopeful that grown-ups will take over and we will do what is necessary. I hope so. If we don't, then things will just get worse and worse.

Do we have enough time to avoid the warming that will bring severe and damaging effects of climate change?

It's not going to happen in time for 1.5 degrees. It's very unlikely to happen for 2 degrees. We'd have to be very pessimistic about the economy or optimistic about technology for 2 degrees. If we start moving very swiftly in the next 20 years, we might be able to avoid 2 degrees, but if we don't do that, we're in for changes in the earth's system that we can't begin to understand in depth.

Warming of 4, 5, 6 degrees will bring changes we don't understand because it's outside the range of human experience in the last 100,000 to 200,000 years.

We've been going backward for the last two years. Maybe we can stop going backward and start going forward.

Trump aims to counter China through aid

FOREIGN AID, FROM PAGE 7

civilian nuclear technology to China.

The new bipartisan push to increase foreign aid began under the Obama administration, but it was rebranded as a means of competing with China's Belt and Road initiative, which has a goal of distributing $1 trillion in construction aid and investments to over 100 countries.

China's biggest investments are targeted to countries, like Pakistan and Nigeria, with a goal of expanding Beijing's geopolitical power and gaining access to natural resources like minerals and oil. But it is also spending billions on projects in smaller countries that are less likely to turn a monetary or political profit. Last month, President Xi Jinping said China would provide $60 billion in financial support to Africa, including credit lines, grants and investment financing.

The investments have raised concerns that poor and emerging nations like Djibouti and Sri Lanka could be increasingly beholden to China, which can seize local assets if countries default on loans.

"The whole point of China's activity is building things no one else wanted to build — rail lines between African countries that hate each other, roads in bad terrain, power plants that are never going to make any money," said Derek M. Scissors, a resident scholar at the American Enterprise Institute who studies the Chinese and Indian economies.

"If a country can't pay, they will take assets they want," he added. "But they aren't setting a debt trap. This is about expanding their reach and exercising passive power."

The United States' initiative is far less ambitious. But it "allows us, at least, to compete," said Tom Hart, North America executive director of ONE, the development nonprofit that the musician Bono helped found.

The new agency will supplant the Overseas Private Investment Corporation, established in 1971 as a lending facility to encourage American companies to invest in developing countries, and will have twice its overall lending capacity. The new entity, like the old, is funded primarily through fees, and will provide loans, loan guarantees and political risk insurance to companies willing to take the gamble of investing in developing countries.

ATUL LOKE/BLOOMBERG

A project in Colombo, Sri Lanka, financed by a Chinese company. Beijing has a goal of distributing $1 trillion in construction aid and investments to more than 100 countries.

The Overseas Private Investment Corporation has earned millions of dollars each year for the Treasury Department, the result of a conservative investment strategy including loans to American corporations for relatively low-risk projects, such as a $400 million loan to General Electric, Bechtel and other investors in 2015 to build Egypt's biggest petrochemical plant.

The new $60 billion aid program was tucked into a five-year reauthorization of the Federal Aviation Administration and its passage was the product of a quiet, bipartisan effort. It included ONE, the Brookings Institution, conservative House members like Mr. Yoho and Commerce Secretary Wilbur Ross. It was led by Ray Washburne, the president of the Overseas Private Investment Corporation and a top Republican fund-raiser from Texas.

The corporation, like most other foreign development agencies, has come under heavy fire from the right, which has argued that such assistance is a waste of federal resources and a form of corporate welfare. During President Barack Obama's second term, the Republican-controlled House balked at reauthorizing the agency.

During his presidential campaign, Mr. Trump vowed to "stop sending aid to countries that hate us."

"I'm astonished, to be honest. I still can't believe we got it done," said Senator Chris Coons, Democrat of Delaware, who sits on the Senate Foreign Relations Committee. "We've been working on this since 2015. It is basically the same proposal we had under the Obama administration. We rebranded to focus it on China."

The agency contains new accountability measures and includes reporting requirements to prevent gender discrimination and the use of child labor, but it is otherwise similar to its predecessor.

Shortly after being picked as budget director last year, Mick Mulvaney — with the president's enthusiastic support — proposed slashing the State Department's foreign aid budget by one-third, a plan that zeroed out the Overseas Private Investment Corporation's budget.

"It is not a soft-power budget," Mr. Mulvaney explained at the time. "This is a hard-power budget."

Soft power has, however, proved hard to kill.

Congressional Republicans rejected Mr. Mulvaney's cuts. And Secretary of State Mike Pompeo fought Mr. Mulvaney's attempts to claw back $3 billion in foreign aid spending this year, telling Mr. Trump that the cuts would weaken the country's position in the world and his own standing with the department's pro-foreign-aid career staff, according to two administration officials with knowledge of the exchanges.

In the end, Mr. Yoho sold Mr. Mulvaney on supporting the expansion of the investment fund, arguing that its expansion would probably cost taxpayers nothing.

Senator Bob Corker, the chairman of the Senate Foreign Relations Committee, emphasized that the initiative represents a strategic shift. Mr. Trump seems to be learning that the projections of military power alone will not be enough to compete with China, he said.

"We're seeing what China is doing throughout Africa and South America, especially Venezuela, and people are waking up and realizing we have to have involvement with the countries, not just for a return on investment, but to move them toward a market-based approach," said Mr. Corker, a Tennessee Republican who is not running for re-election. "So much of our foreign policy now is focused on trying to check China, especially their nefarious activities."

Significant questions remain about how the fund will operate in its new expanded form. The key to its success, development officials said, is to create a new system that will carefully vet investments for maximum economic and political impact — and to ensure that projects don't fail as a result of corruption and mismanagement.

A bigger question is whether it will do anything to reduce China's influence.

"I'm pretty skeptical," said Mr. Scissors, the resident scholar at the American Enterprise Institute. "The whole concept is that we give more money to big players who make investments in places where they don't lose money. We've finessed the public relations problem. But we aren't really competing with the Chinese."

Voters may take no heed when the markets dive

STEWART, FROM PAGE 7

Senate (where Bernie Sanders and Joe Lieberman joined 49 Democratic senators for an effective Democratic majority).

Polls that year suggested that voter frustration over the Iraq war, Mr. Bush's proposal to privatize Social Security and the Republican-controlled Congress's scant achievements outweighed the positive economic backdrop.

Many investors feared that the loss of Republican majorities would hurt financial markets. But the Standard & Poor's 500-stock index ended 2006 with an impressive gain of nearly 16 percent.

In 2010, during President Barack Obama's first term, the economy was growing at a respectable 2.5 percent rate, and the stock market was up nearly 7 percent.

Yet Democrats suffered widespread midterm losses. Republicans captured 63 seats in the House, regaining the majority, and gained six seats in the Senate. With the Tea Party wing of the Republican Party whipping up resentment about Wall Street bailouts and high unemployment, Democrats weren't able to capitalize on either rising stock prices or the economy's return to growth.

Neither do plunging stock prices seem to have much impact on the electorate. In 2002, when the bursting technology bubble caused the S.&P. 500 to drop 22 percent, the president's party — in this case the Republicans during Mr. Bush's first term — gained seats in the House and Senate.

Heading into the 1966 midterms, with Lyndon B. Johnson in the White House, stocks were in a bear market, having fallen 22 percent that year from peak to trough.

Yet, the incumbent Democrats fared relatively well, losing only three seats in the Senate and 46 seats in the House and maintaining control of both chambers.

The good news for investors is that just as stock prices and the economy appear to have little impact on midterm results, the converse is also true: The outcome of congressional elections has little or no impact on stock prices and the economy. "Whatever the momentum there is going into the elections tends to continue," Mr. Parker said. "Politics don't seem to have much impact."

He found that, on average, stocks gained 14.5 percent from the end of August to the end of March in the year after midterm elections. That compares with average gains of 6.1 percent over the same period in non-midterm years.

Of the 17 midterm election periods Mr. Parker analyzed, only two — 1978 and 2002 — were followed by market drops.

The converse is also true: The outcome of the midterms has little or no impact on stock prices.

There have been six midterms where one or both houses of Congress experienced a change in control. That had no impact on stocks: The average gains in those years were the same as in years when there was no change in control.

The reason stocks do so well around midterm elections, Mr. Parker theorized, is that valuations before the elections tend to be lower than fair value, perhaps because investors are overly concerned about the risk of political change. (That doesn't appear to have been much of a factor in this week's drop, which was fueled in large part by concerns about rising interest rates and a trade war with China.)

Mr. Parker's reasoning suggests that any pre-election weakness is a buying opportunity.

Mr. Parker cautioned that the period he studied provides too few midterm elections, and thus too little data, to draw any firm conclusions. Still, the market's outsize gains around midterms are "a significant statistical anomaly," he said.

This year, the S.&P. 500 is down more than 4.5 percent since the end of August. That means there will have to be a big rally by next spring if Mr. Parker's pattern is to continue.