

Lecture 05

Taxes

Ivan Rudik
AEM 4510

Roadmap

1. What are the different kinds of price instruments in theory and the real world?
2. What happens under a tax?

Taxes

Emission taxes

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Solves the two big problems with externalities:

1. Poorly defined property rights (assigned to the regulator)
2. High transactions costs (pay a flat fee)

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We know abatement costs are decreasing in emissions and damages are increasing in emissions

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This means that the regulator's optimal tax is given by:

$$\tau^* = D'(E^*)$$

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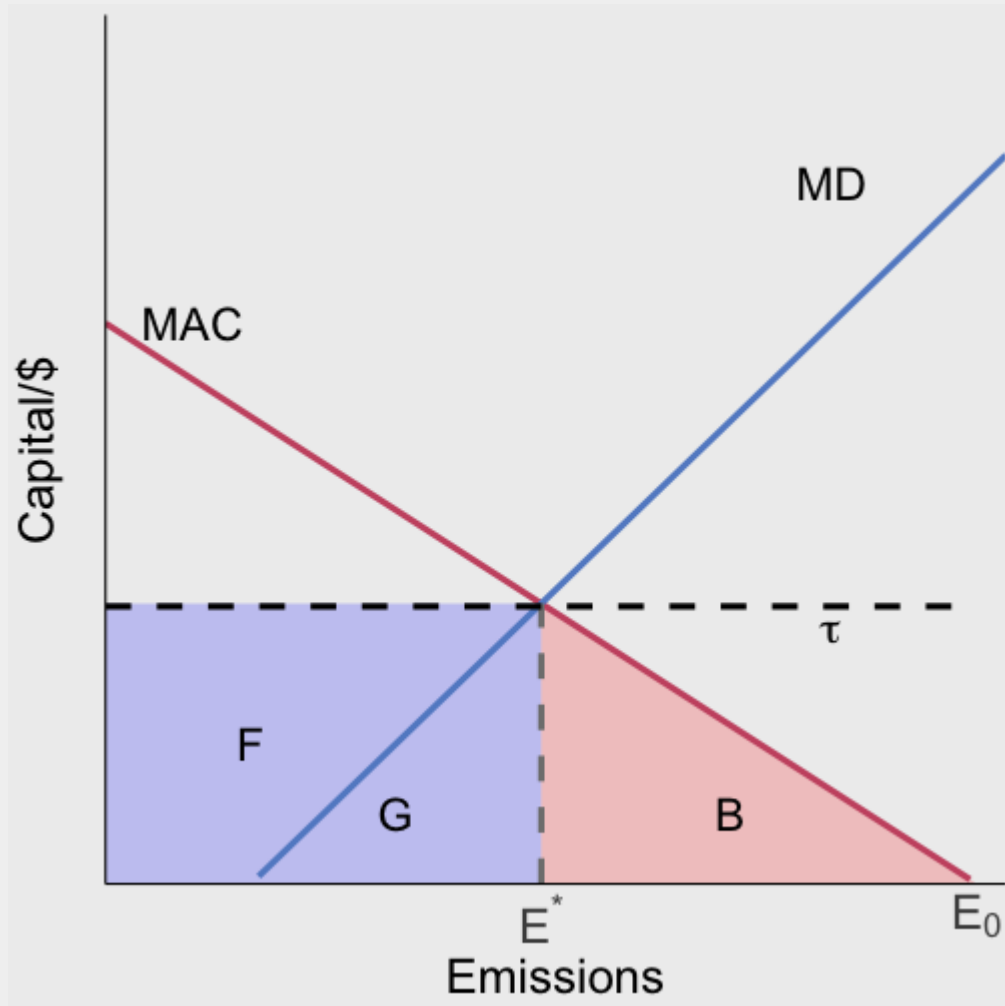
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We want the firm to act as if they are bearing the damage costs on the margin

The tax actually makes them bear a cost exactly equal to marginal damage

Emission taxes: graphical



The optimal tax equals MD at E^*

You can think of this as the firm being forced to pay for damages equal to the cost of the last unit of emissions

In addition to paying abatement cost equal to the red area B , the firm also has a tax payment equal to the blue area $F + G$

Emission taxes: real world

Australia started carbon tax on July 1, 2012

\$23 AUD per ton of carbon emitted for large emitters as a response to the Copenhagen Accord of 2009

Australia hopes to reduce carbon emissions by 80% below 2000 levels by 2050

Started by Julia Gillard government and revoked by Tony Abbott government in July 2014

Emission taxes: real world

In 2008, the province of British Columbia implemented North America's first broad-based carbon tax

The carbon tax applies to the purchase and use of fossil fuels and covers approximately 70% of provincial greenhouse gas emissions

Beginning April 1, 2018, B.C.'s carbon tax rate is \$35 per tonne of carbon dioxide equivalent emissions

To improve affordability, government increased the Climate Action Tax Credit

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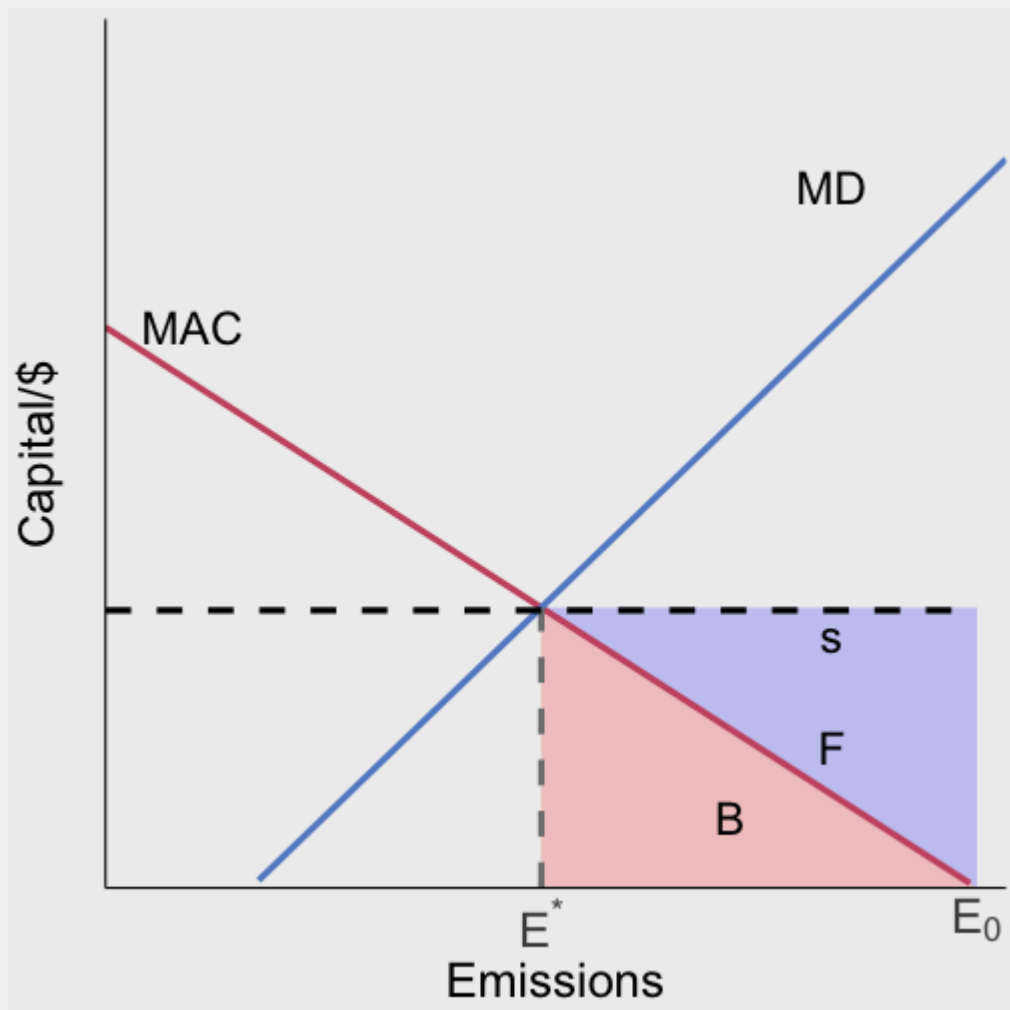
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Abatement subsidies

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