



Free markets. Real solutions.

R STREET POLICY STUDY NO. 45
November 2015

THE TEXAS PATH: PRESERVING ENERGY SOVEREIGNTY TO CUT TAXES

Josiah Neeley

INTRODUCTION

Texas faces some tough energy choices. Under the U.S. Environmental Protection Agency's Clean Power Plan (CPP),¹ Texas is expected by 2030 to have reduced carbon dioxide (CO₂) emissions from existing electrical generation units (EGUs) by between 21 and 33 percent.² Dealing with the fallout from the CPP will have profound implications for Texas' economy, environment and electric grid.

Given this, it is important to make a clear-eyed evaluation of Texas' options to respond. This paper looks at one such option: imposing a fee on electricity generated from CO₂-emitting sources, with all resulting revenue returned to taxpayers in the form of cuts to existing taxes. This approach would not foreclose existing or future legal or legislative

1. Gina McCarthy, "Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Utility Generating Units ('Final Rule')," U.S. Environmental Protection Agency, Aug. 3, 2015. <http://www.epa.gov/airquality/cpp/cpp-final-rule.pdf>

2. Rob Lawrence, "Clean Power Plan: State at a Glance - Texas," U.S. Environmental Protection Agency, Aug. 3, 2015. <http://www3.epa.gov/airquality/cpptoolbox/texas.pdf>.

CONTENTS

Introduction	1
Part I - The Clean Power Plan	2
Part II - Using carbon fees to offset other taxes	3
Eliminate the Franchise Tax	4
STaR Fund with automatic sales-tax cuts	5
Property tax reform	6
Part III - Options to fight the CPP	6
Conclusion	7
About the author	7
FIGURE 1: Revenue generated by Texas franchise tax	4
FIGURE 2: Incidence of Texas sales tax	5
FIGURE 3: Incidence of Texas property taxes	6

challenges to the CPP. However, it would achieve three other crucial goals:

1. **Using market mechanisms** to achieve emissions reductions at the lowest-feasible cost;
2. **Providing needed tax relief** to Texans; and
3. **Allowing Texas to escape** a federal regulatory approach.

It also would reassert the traditional division of power between states and the federal government on matters of environmental policy.

Part I will briefly summarize the CPP, both in general and as it is proposed to apply to Texas. Part II lays out the details of an emissions-fee approach to CPP compliance and gives several specific examples of how the tax swap could be implemented. Part III looks at how an emissions-fee approach can be incorporated into alternate strategies for how Texas should respond to the CPP.

PART I – THE CLEAN POWER PLAN

In 2009, the EPA formally determined that emissions of six greenhouse gases, including CO₂, posed a danger to human health and should be regulated as pollutants under the Clean Air Act.³ Based on this finding, the agency has since promulgated or is in the process of promulgating a series of regulations regarding greenhouse-gas emissions, including rules governing fuel-economy standards for automobiles and standards for new power plants.⁴ While the CPP is not the first EPA regulation of CO₂ emissions, it is far broader – both in scope and in effect – than prior rules.

Under the CPP, each state may choose one of two emissions standards:

1. A **rate-based standard** that applies to average emissions per kilowatt-hour of electricity generated; or
2. A **mass based** standard that limits the total amount of CO₂ emitted from existing electrical generation.⁵

The CPP's rate-based standard for Texas in 2030 is 1,042 pounds per megawatt-hour (MWh) of electricity generated, which would represent a 33 percent reduction from the 2012 baseline of 1,566 pounds/MWh. Texas' mass-based goal for 2030 is 190 million tons per year, a 21 percent reduction from the 2012 baseline of 241 million tons/year. The CPP also includes interim rate- and mass-based goals for each state, to be achieved during the period of 2022 to 2029. Texas' interim rate- and mass-based goals are 1,188 pounds/MWh and 208 million tons per-year, respectively.⁶

3. U.S. Environmental Protection Agency, "Endangerment and Cause or Contribute Findings for Greenhouse Gases under Section 202(a) of the Clean Air Act; Final Rule," *Federal Register*, 74 Fed. Reg. 66496 Et. Seq., Dec. 15, 2009. http://www3.epa.gov/climatechange/Downloads/endangerment/Federal_Register-EPA-HQ-OAR-2009-0171-Dec.15-09.pdf

4. See, e.g., Environmental Protection Agency and the National Highway Traffic Safety Administration, "Light-Duty Vehicle Greenhouse Gas Emission Standards and Corporate Average Fuel Economy Standards; Final Rule," *Federal Register*, 75 Fed. Reg. 25324, May 7, 2010. <https://www.federalregister.gov/articles/2010/05/07/2010-8159/light-duty-vehicle-greenhouse-gas-emission-standards-and-corporate-average-fuel-economy-standards>; See also: Environmental Protection Agency, "Reconsideration of Interpretation of Regulations That Determine Pollutants Covered by Clean Air Act Permitting Programs; Final Rule," *Federal Register*, 75 Fed. Reg. 17004, 17019 April 2, 2010. http://www2.epa.gov/sites/production/files/2015-07/documents/co2recon_psd.pdf; Environmental Protection Agency, "Standards of Performance for Greenhouse Gas Emissions From New Stationary Sources: Electric Utility Generating Units; Proposed Rule," *Federal Register*, 79 Fed. Reg. 1430, Jan. 8, 2014. <https://www.federalregister.gov/regulations/2060-AQ91/standards-of-performance-for-greenhouse-gas-emissions-from-new-stationary-sources-electric-utility-g>

5. In its final rule, the EPA did not set standards for Alaska or Hawaii, on the grounds that it lacked sufficient technical information. In addition, the CPP contains no emissions-reduction standards for Vermont, which historically has generated electricity largely from non-carbon emitting sources.

6. The CPP also contains sub-goals (called "milestones") for periods within the 2022 to 2029 timeline. However, states are free to choose different interim milestones as long as they achieve the interim and final goals. See Lawrence, "Clean Power Plan: State at a Glance – Texas."

In responding to the CPP, each state faces a number of options. First, a state must choose whether to develop a state plan to achieve the CPP's emissions goals. States that choose to develop their own plans may do so in several ways. In keeping with the dual rate- and mass-based standards, a state can decide whether it wants to develop emissions standards for each EGU or a "state measures" approach. The latter would use any number of programs to achieve the required average emissions reductions across existing EGUs.

The EPA has streamlined planning requirements for a states that opt for a mass-based standard, but the state must ensure that its plan would not result in higher emissions from new generation. Unlike a typical state implementation plans submitted under the Clean Air Act, the elements in a state measures plan would not be federally enforceable.

A state measures plan could involve anything from energy efficiency mandates to market-based mechanisms, as long as it is expected to achieve the CPP's emissions goals. In particular, the EPA notes in its final rule:

"[T]he state measures plan type could accommodate imposition by a state of a fee for from affected EGUs, an approach suggested by a number of commenters. This plan type would allow the state to implement a suite of state measures that are adopted, implemented, and enforceable only under state law, and rely upon such achieving the required level of performance from affected EGUs."⁷

States have until September 2016 to submit an initial plan to the EPA. However, this initial filing need not be complete or final. If a state is unable to complete a full emissions-reduction plan by the September 2016 deadline, it may apply for a two-year extension if it meets three basic requirements. First, it must identify either the final plan approach or approaches the state is considering and include a description of progress made toward preparing the plan. The state "need not commit in their initial submittal to any one plan approach, and... may identify more than one approach." Nor does the submission have to include "technical data or quantitative analyses." The submission can be very general. Nothing in it ultimately commits a state to pursue that particular course.

A state seeking an extension also must explain why it needs more time. Finally, the state must provide opportunities for public comment on the plan approaches it is considering, including input from vulnerable communities.⁸

7. Final Rule, at 899.

8. Stephen D. Page, "Initial Clean Power Plan Submittals under Section 111(d) of the Clean Air Act," Office of Air Quality Planning and Standards, Oct. 22, 2015. <http://www3.epa.gov/airquality/cpptoolbox/cpp-initial-subm-memo.pdf>

If a state declines to submit a plan, or if the EPA deems the plan inadequate, the agency will instead impose its own plan to achieve the reduction goals. Along with its final rule, the EPA released a model federal rule, which gives an indication of what this federal plan might look like. The model rule imposes emissions rate limits on individual EGUs, but allows EGUs to buy credits from other low- or zero-emissions sources to offset some of their own emissions. One can conclude from this model that a state that does not enact its own plan effectively will be subject to a version of cap-and-trade, involving direct regulation of power generators.

Should an EGU refuse to comply with the federally imposed plan, the Clean Air Act provides the EPA with several means of enforcement. Specifically, if a person is found to be violating the FIP, the act gives the agency authority to “(A) issue an administrative penalty order...(B) issue an order requiring such person to comply with such requirement or prohibition, (C) bring a civil action [or] (D) request the Attorney General to commence a criminal action.”⁹

PART II – USING CARBON FEES TO OFFSET OTHER TAXES

How Texas responds to the CPP will have enormous implications for the future economic health of the state. As discussed below, Texas could use emissions fees to satisfy the federal requirements, keep the EPA out of the state’s power-market regulation and provide the opportunity for long-awaited pro-growth tax cuts.

By contrast, if Texas is saddled with a poorly designed plan, the results will be costly. For example, an analysis by NERA Consulting of the CPP proposed rule found that, if Texas were to implement a lowest-cost plan for reducing emissions, electricity prices would rise by 10 percent. However, the analysis found that if Texas were to attempt to achieve the same emissions reductions solely through restrictions on emitting plants, prices would increase by 64 percent.¹⁰

Economists generally agree that the least costly way to reduce emissions is through an emissions fee.¹¹ Unlike specific bureaucratic mandates, an emissions fee would allow generators flexibility to achieve emissions reductions in the most cost-effective manner. The fee could be based either on the volume or the rate of emissions and could be administered by the state’s grid manager, the Electric Reliability Council of Texas (ERCOT), without compromising Texas’ competitive market for electrical generation.

9. 42.U.S.C. §7413(a)(3). <https://www.law.cornell.edu/uscode/text/42/7413>

10. David Harrison, et al., “Potential Energy Impacts of the EPA Proposed Clean Power Plan,” NERA Economic Consulting, Figures 17 and 18, October 2014. http://www.nera.com/content/dam/nera/publications/2014/NERA_ACCCE_CPP_Final_10.17.2014.pdf.

11. See, e.g., Shi-Ling Hsu, *The Case for a Carbon Tax*, Island Press, September 2011.

An emissions-fee approach would have the added benefit that it would generate revenue that could be used to cut existing state taxes. To the extent that an emissions fee is used to offset cuts to more burdensome taxes, the swap can be economically as well as environmentally beneficial.

As part of the supporting documents for the CPP, the EPA conducted modeling that includes estimates of how big a price would have to be put on each ton of CO₂ for a state to achieve its required emissions reductions.¹² By multiplying the “shadow” carbon price from this modeling by the number of tons of CO₂ a state is allowed to emit under the CPP, we can derive a rough estimate of the additional cost to consumers that the CPP would impose in the form of higher electricity prices.¹³

The EPA estimates that Texas would need to impose a fee of around \$13.75 per ton of CO₂ emissions from existing electrical generation to meet its CPP mass-based goal in 2030.¹⁴ Since Texas’ mass-based goal for 2030 under the CPP is 190 million tons of CO₂ per year, an emissions fee of \$13.75 per ton would generate about \$2.6 billion in revenue per year.

ERCOT has similarly calculated the implicit carbon price necessary to meet Texas’ mass-based goal. ERCOT’s conclusions are somewhat more pessimistic, finding that Texas would need to impose a price of between \$21 and \$22.50 per ton of CO₂ in 2030 to meet its CPP mass-based goal.¹⁵ If ERCOT’s estimate is correct, a properly designed emissions fee would generate between \$4 billion and \$4.3 billion a year.

While the revenue generated by this emissions fee would be substantial, it is essential that it not be used to grow the size of government. Texas already takes in sufficient tax revenue to fund essential government services. In any case, the state’s constitutional spending limit would preclude large amounts of additional spending. Further, simply spending the revenue would do nothing to alleviate the costs imposed by the CPP.

Instead, Texas should offset the revenue from an emissions fee by making comparable cuts to other, more burdensome taxes. If structured properly, the economic benefits from these tax cuts have the potential to offset, if not exceed, the costs of the CPP itself. Instead of being a threat to Texas’

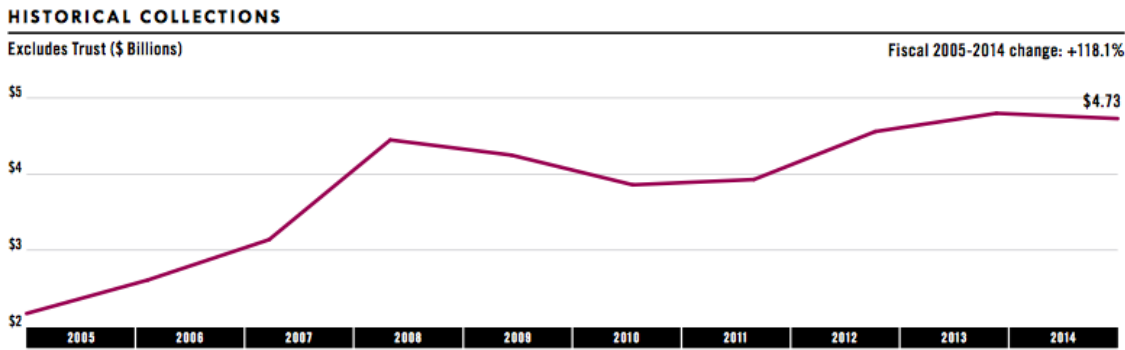
12. Calculations are based on mass-based standards, rather than rate-based standards.

13. Mass-based CO₂ limits for each state in 2030 are derived from the EPA’s state-specific fact sheets, available here: <http://www2.epa.gov/cleanpowerplanttoolbox/clean-power-plan-state-specific-fact-sheets>

14. The carbon price for Texas listed in the EPA’s modeling is \$13.02 per ton in 2011 dollars, which translates to \$13.79 in today’s dollars.

15. The lower \$21 per ton of CO₂ price assumes that the EPA’s proposed Regional Haze rule goes into effect. See: Electric Reliability Council of Texas Inc., “ERCOT Analysis of the Impacts of the Clean Power Plan, Final Rule Update,” ERCOT, Oct. 16, 2015. http://www.ercot.com/content/news/presentations/2015/ERCOT_Analysis_of_the_impacts_of_the_Clean_Power_Plan-Final_.pdf.

FIGURE I: REVENUE GENERATED BY TEXAS FRANCHISE TAX



SOURCE: Texas Comptroller of Public Accounts

economy, an emissions-fee plan could provide the opportunity for much needed tax reform.

Based on the estimates provided above, a fee-based Texas emissions-reduction plan could allow for \$5.2 billion to \$8.6 billion in tax relief per biennium. At the high end, this would be more than double the \$3.8 billion in tax relief enacted during the 84th Legislative Session, which was one of the largest (if not the largest) tax cuts in Texas history.

Texas is fortunate in that it does not have a state income tax, nor a tax on capital income. However, the state still has numerous taxes that could be reduced or eliminated. Property taxes are too high, and there is a growing consensus that they need to be reformed. Texas' business franchise tax harms both consumers and Texas' economic competitiveness, while delivering little revenue to the state treasury. Revenue Texas' severance tax on oil-and-gas production can vary substantially due to factors in the energy market. And the burden of Texas' sales tax falls disproportionately on lower-income Texans.

A comprehensive review of all the possible tax swap options is beyond the scope of this paper. Instead, I provide several examples of how an emissions fee/tax swap might work to give a sense of some of the state's options for revenue offsets. A state emissions plan could include any of these options, either alone or in combination, or other options not considered.

ELIMINATE THE FRANCHISE TAX

On a dollar-for-dollar basis, the franchise tax (also known as the margin tax or, in economic parlance, a "gross receipts tax") is probably Texas' most economically damaging tax. The tax is a 0.75 percent levy on businesses' "taxable margins," (lowered to 0.375 percent for businesses primarily engaged in retail). "Taxable margins" is defined as the lesser

of "total revenue minus cost of goods sold; total revenue minus compensation; or total revenue times 70 percent."¹⁶

While all businesses in the state pay one of the two official tax rates, the tax is structured such that businesses in different industries end up paying substantially different effective rates. Industries that involve extended production chains, for example, must pay the tax based on receipts at multiple points along the chain, with the costs of the tax ultimately paid by the consumer in the form of higher prices. A recent analysis concluded that repeal of the margin tax could increase personal income in Texas by \$16 billion.¹⁷

Over the last decade, roughly \$4 billion to \$5 billion a year has been generated by the franchise tax. During the 84th Legislative Session, the franchise tax rate was reduced by 25 percent, which should reduce yearly revenues from the tax by around \$1.2 billion a year.¹⁸ The state Legislature also formally announced that it would seek ways to eliminate the tax altogether. A major confounding issue is how to make up the lost revenue.

Expected revenue from an emissions fee would offset the bulk of the lost revenue from a franchise tax repeal. The remainder would have to be made up via spending restraint. The timeline to meet the CPP's 2030 goals would allow the franchise tax to be phased out over time, which (as discussed below) would give Texas' power sector time to adapt and give

16. Glenn Hegar, "Texas Franchise Tax," Office of the Texas Comptroller of Public Accounts, last accessed Nov. 11, 2015. <http://www.window.state.tx.us/taxinfo/franchise/margin.html>

17. Vance Ginn and Talmadge Heflin, "Economic Effects of Eliminating Texas' Business Margin Tax," Texas Public Policy Foundation, March 2015. <http://www.texaspolicy.com/library/doclib/MarginTax-CFP.pdf>

18. Ursula Parks, "Fiscal Note, 84th Legislative Session, In Re: HB 32," Legislative Budget Board, May 25, 2015. <http://www.legis.state.tx.us/tlodocs/84R/fiscalnotes/html/HB00032F.htm>

FIGURE 2: INCIDENCE OF TEXAS SALES TAX

Quintile	Household Income	Amount	Percent of Total Tax Paid	Tax as a Percent of Total Income
1	Less than \$34,161	\$2,171.9	6.9%	7.5%
2	\$34,161 - 61,955	3,136.1	9.9%	4.1%
3	\$61,955 - 94,319	4,374.3	13.8%	3.6%
4	\$94,319 - 147,411	5,944.4	18.8%	3.1%
5	\$147,411 and higher	9,370.3	29.6%	1.7%
Residents		\$24,997.0	79.1%	
Exported		\$6,621.6	20.9%	
TOTAL		\$31,619.0	100.0%	

SOURCE: Texas Comptroller of Public Accounts

the state time to resolve any legal challenges to the CPP rule itself. While R Street long has supported full elimination of the franchise tax, with or without a replacement revenue stream, eliminating the tax as part of a Texas emissions plan would achieve two vital state objectives.

STAR FUND WITH AUTOMATIC SALES TAX CUTS

Texas' sales tax brings in the most revenue of any state tax, and is one of the broadest taxes in its impact. The current sales tax rate is 6.25 percent, with each percentage point of the tax bringing in approximately \$4 billion a year. As such, a CPP emissions fee could offset about one percentage point of the tax, bringing the tax rate from 6.25 percent to 5.25 percent, based on current rates. Pairing the carbon fee with an existing proposal to establish a Sales Tax Relief (STaR) fund could further ensure that all revenues generated by the emissions fee are returned to the taxpayer.

The STaR fund is a mechanism to make it easier for state revenues to be returned to the people via lower taxes.¹⁹ Currently, a portion of Texas' severance-tax collections on oil-and-gas production is transferred to the state's Economic Stabilization Fund (ESF). When the ESF balance reaches a constitutionally set cap, additional funds that ordinarily would go into the ESF are instead diverted to the general treasury.

Under the original STaR fund proposal, these severance-tax collections (along with any revenue the Legislature appropriated for that purpose) would instead go into a special fund, which could be used to offset reductions in the state sales tax. If established, the STaR fund similarly could include a provision stating that funds collected from the emissions fee on power generation flow directly into the STaR fund. Paired with additional revenue from an emissions fee, the state comptroller would exhaust the fund's balance periodically by lowering the state's sales tax rate. This would keep revenue out of the general treasury and return more tax revenue to Texans.

As with franchise-tax repeal, R Street supports establishing a STaR fund regardless of how Texas chooses to respond to the CPP. But as with the previous option, using a STaR fund as part of an emissions-reduction plan could provide added benefits for Texas. This approach would have a number of advantages. Sales-tax reductions are well-calibrated to offset pain arising from the higher electricity prices caused by the CPP. Low-income households typically spend a higher percentage of their income on electricity. One analysis found that Texas households making less than \$30,000 a year spent 9 percent of their after-tax income on electricity, while households making more than \$50,000 a year spent only 2 percent of after-tax income on electricity.²⁰ As such, higher electricity prices are a particularly regressive policy effect.

Sales taxes are likewise regressive. According to a recent analysis by the Office of the Texas Comptroller, households

19. For a fuller description of the STaR fund, see Talmadge Heflin and Vance Ginn, "Protecting Texas Taxpayers: Sale Tax Relief (STaR) Fund," Texas Public Policy Foundation, April 2014. <http://www.texaspolicy.com/library/doclib/2014-04-PP11-ProtectingTexasTaxpayers-CFP-HeflinGinn-0.pdf>

20. American Coalition for Clean Coal Electricity, "Energy Cost Impacts on Texas Families," March 2015. <http://americaspower.org/sites/default/files/TEXAS-Energy-Cost-Analysis-315R.pdf>

FIGURE 3: INCIDENCE OF TEXAS PROPERTY TAXES

	Amount	Percent
Homeowners	\$18,741.6	60.6%
Renters	5,598.1	18.1%
Subtotal	\$24,339.7	78.7%
Exported	\$6,591.7	21.3%
TOTAL	\$30,931.4	100.0%

Totals may not add due to rounding.

SOURCE: Texas Comptroller of Public Accounts

making less than \$34,161 paid 7.5 percent of their income in sales tax, compared to 1.7 percent for the highest income group (those making more than \$147,411). The percentage of income paid in sales tax is thus nearly four and a half times higher for the poorest households than for the richest ones.²¹

The STaR fund approach would thus roughly tie the amount of tax relief each household receives to the cost that household would face from higher electricity prices, both in nominal terms as a percentage of household income.

In addition, the STaR fund approach would ensure that revenue from the emissions fee is returned to taxpayers, regardless whether current revenue estimates prove correct. By contrast, attempts to offset future emissions-fee revenues by eliminating taxes or by specific rate reductions can only achieve a rough parity. Revenue from existing taxes often varies substantially from year to year and there is no guarantee the revenue from an emissions fee in 2030 would exactly match the revenue from the repeal of an existing tax in 2030.

PROPERTY TAX REFORM

Property taxes amount to almost half of all state and local tax revenues. Texans now pay an average of almost 10 percent of their income in property taxes²² and the situation is getting worse. Property taxes in Texas increased 101 percent between 2000 and 2013, far outstripping inflation and population growth.²³ There is a growing consensus that Texas needs serious property-tax reform.²⁴

21. Glenn Hegar, "Tax Exemptions and Tax Incidence," Texas Comptroller of Public Accounts, March 2015. http://www.texastransparency.org/State_Finance/Budget_Finance/Reports/Tax_Exemptions_and_Incidence/incidence15/96-463_Tax_Incidence2015.pdf

22. U.S. Census Bureau, retrieved Nov. 11, 2015. <http://quickfacts.census.gov/qfd/states/48000.html>.

23. Susan Combs, "Biennial Property Tax Report: Tax Years 2012 and 2013," Texas Comptroller of Public Accounts, December 2014. <http://comptroller.texas.gov/taxinfo/proptax/pdf/96-1728-12-13.pdf>

24. See, e.g., Kathleen Hunker, James Quintero and Vance Ginn, "The Freedom to Own Property: Reforming Texas' Local Property Tax," Texas Public Policy Foundation,

In addition, there is a significant correlation between the amount a landowner pays in property taxes and the impact of higher electricity prices. Larger homes with higher appraised values also are likely to use more electricity. As with the sales tax, Texas' property tax is regressive. Even renters ultimately are burdened by the tax, in the form of higher rents. According to the Texas comptroller, a full 18.1 percent of Texas' property tax burden was borne by renters.²⁵

In November 2015, Texas voters approved a \$10,000 increase in the state's homestead exemption for school district property taxes. There also have been a number of proposals to make systematic changes to the way property taxes are assessed or raised by requiring voter approval for increases beyond a certain percentage. While it's difficult to estimate just how large an effect these measures would have on property-tax revenue, it certainly would be possible to pair one of these property-tax-reform measures with an emissions fee as part of Texas' CPP-compliance plan.

PART III – OPTIONS TO FIGHT THE CPP

The choice Texas faces is whether to enact a policy to comply with the CPP, or be saddled with the federal plan. As described above, a properly designed Texas plan can minimize the costs of meeting the CPP's goals while also lowering taxes and reducing economic harm. A federal plan would invite direct federal control over Texas' power generators. Texas has long and rightly sought to avoid federal control over the state's electrical system, even going so far as to maintain a separate electrical grid to preserve our energy independence. A federal plan would therefore not only be more economically costly than some potential state plans, but would be profoundly damaging to state sovereignty.

Texas has options to resist the EPA and the CPP. Legal challenges to the rule already have begun and the governor and attorney general both are interested in using the courts to dismantle the rule completely. Similarly, political campaigns seeking to get Congress to remove the EPA's statutory authority to issue the CPP also are underway.

Pursuing these strategies to resist the regulation is a necessary first step, but should not preclude work on a state plan. Filing a legal challenge will not stop the CPP from going into effect unless Texas can get a federal court to issue a preliminary injunction. The legal challenge will take several years to resolve. In the meantime, the EPA will continue to implement the rule. Thus, Texas could be forced to adopt a federal plan before the case is resolved. Even if the rule ultimately is invalidated, the prospect of operating under a federal plan

October 2015. <http://www.texaspolicy.com/content/detail/the-freedom-to-own-property-reforming-texas-local-property-tax>

25. "Tax Exemptions and Tax Incidence," supra, at p. 62.

could force generators into making decisions regarding capital expenditures or continued operations that would be very costly to Texas. At the very least, the regulatory uncertainty involved would be a drag on Texas' economic growth.

The experience of Texas in dealing with prior EPA rules illustrates some of the dangers involved. In 2012, Texas filed suit challenging the legality of the EPA's Utility MACT rule. In 2015, the Supreme Court handed down *Michigan v. EPA*, which found the rule was contrary to law. To a large extent, this turned out to be a pyrrhic victory, as utilities had complied with the rule just two months earlier.²⁶

A similar story played out with respect to the EPA's prior greenhouse gas regulations. When the EPA released its initial set of greenhouse gas regulations, TCEQ declined to issue greenhouse gas emissions permits, citing (correctly) that it lacked statutory authority to do so. As a result, permitting was to be handled directly by the EPA. In addition, Texas challenged the rule in court. Yet as the litigation dragged on, Texas businesses found their attempts to receive permits were stalled by the EPA's slow and unwieldy bureaucratic approach.

During the 83rd session, the Legislature passed H.B. 788, which gave TCEQ authority to issue the permits while the litigation was ongoing. The bill explicitly included provisions that would revoke TCEQ's authority if the EPA's regulations were found to be unlawful. By taking this tact, Texas was able to limit the harm from direct federal regulation without undermining the legal challenge.²⁷

If properly designed, a CPP-compliant carbon fee could maintain Texas' sovereignty and compliment other desirable tax reform. The fee could be phased in over time, allowing legal challenges to be resolved before industry needs to undertake major capital expenditures under the rule. Legislation implementing the Texas emissions plan also could include language similar to that in H.B. 788, revoking the authority for a carbon fee should the CPP be repealed or invalidated in court.

CONCLUSION

Ultimately, Texas must remain in control of its own destiny. A resilient power sector is vital to the state's economy and the well-being of its citizens. For more than 40 years, environmental policy has involved a clear division of authority between the federal government and the states: while the

federal government can set national emissions standards, it is up to the states to decide how best to meet those standards. If Texas declines to develop its own CPP plan, it will be ceding authority to the EPA that it may never get back. Such a choice should not be taken lightly.

Luckily, Texas has a way to maintain its traditional state prerogatives without damaging the economic dynamism that has made our state great. Properly implemented, a carbon fee on electrical generation can both meet Texas' CPP goals and provide a vehicle for much-needed tax relief and reform.

ABOUT THE AUTHOR

Josiah Neeley is senior fellow and Texas director for the R Street Institute. He has worked extensively on energy and environmental issues, including federal air quality regulation, climate change, water markets, oil and gas production, renewable energy and electricity.

Josiah was previously a policy analyst for the Center for Tenth Amendment Studies and the Armstrong Center for Energy & the Environment at the Texas Public Policy Foundation.

Before TPPF, Josiah was an associate specializing in constitutional litigation with the firm of Bopp, Coleson & Bostrom in Terre Haute, Ind. He also clerked for U.S. District Court Judge Roger Vinson in Pensacola, Fla.

Josiah's writing has appeared in the *Houston Chronicle*, the *Austin American Statesman*, the *Dallas Morning News*, *First Things*, *The Federalist*, and the *Texas Tech Administrative Law Journal*, among other publications.

He has a bachelor's in government and philosophy from the University of Texas and law degree from Notre Dame Law School. He is a member of the State Bar of Texas.

Josiah and his wife Nicole reside in Round Rock, Texas.

26. Eric Wolff, "Supreme Court's Eventual MATS Ruling Will Be (Mostly) Moot," SNL Energy, May 14, 2015. <https://www.snl.com/InteractiveX/Article.aspx?ccid=A-32620730-13109>

27. The Supreme Court ultimately invalidated the EPA's rule in part and upheld it in part. *Utility Air Regulatory Group v. the EPA*, 134 S.Ct. 2427 (2014). The existence of HB 788 did not affect the outcome of the case.