A carbon tax would provide an incentive to reduce the use of fossil fuels, fostering the growth of clean energy. But it would have another benefit as well: providing revenue to help cut the deficit. Much the same effect could be produced by auctioning allowances within a cap-and-trade system.

According to Resources for the Future, a carbon tax of $10 per ton of CO2 could generate annual tax revenues of $60 billion, and a carbon tax of about $25 could raise roughly $125 billion per year. The amounts are uncertain in part because the tax revenue is sensitive to the price of natural gas — low natural gas prices drive out coal and reduce revenue from the carbon tax. Regardless, the potential for deficit reduction is significant.

The distributive impact of a carbon tax raises some issues. Because low-income consumers spend more of their income on energy and energy-intensive goods, a carbon tax is regressive. Also, there are regional disparities, depending primarily on how much electricity is generated by coal. Thus, it may make sense to use some of the tax proceeds to reduce burdens on the most heavily affected groups, although this would reduce the net revenue from the tax.

In the long run, the carbon tax should produce decreasing revenue as reliance on fossil fuels wanes. But in the shorter-run, the tax could be a significant plus in terms of deficit reduction.