Climate Policy Reform Options in 2025

John Bistline[1], Kimberly Clausing[2], Neil Mehrotra[3], Jim Stock[4], Catherine Wolfram[5]

Introduction and Motivation:

2025 will be a crucial year for US climate policy choices. At the end of 2025, a large number of Tax Cuts and Jobs Act (TCJA) revenue provisions are scheduled to expire. Policymakers on both sides of the aisle have expressed support for extending at least some of the expiring tax cuts, but a full extension comes at a very large revenue cost (approaching $4 trillion over ten years) in a time of increasing deficits and debt. As a result, policymakers might also seek tax increases or spending cuts to pair with TCJA extensions.

A large part of US climate policy operates through the tax code. For example, the Inflation Reduction Act (IRA), the most important climate legislation in US history, was passed through the reconciliation process and relies on tax credits, loans, and direct spending to address US climate change mitigation. But even that historic legislation will only bring the United States partway toward its Paris Agreement commitment of a 50% emissions reduction by 2030, relative to 2005, requiring greater policy action in years ahead.

This combination of fiscal pressures and unmet climate obligations suggests that a range of climate policy options could be under consideration. The objective of this paper is to improve understanding of potential climate policy options facing the US government in 2025. We consider options that might plausibly arise under various outcomes of the 2024 election, including under reconciliation and under a split Congress and/or White House. IRA options considered range from a complete repeal of IRA's clean energy tax incentives to proposals that would double-down on such incentives. We also consider the possibility of new policy tools, including a clean electricity standard as well as a carbon fee, which could be adopted either alongside the complete portfolio of existing clean energy credits, or replace some of them. In evaluating these policy options, our analysis considers key outcomes, including emissions reductions, fiscal impacts, effects on household energy and fuel bills, and economy-wide distributional and macroeconomic impacts.

Outline of Remainder of Paper

Section 2: This section provides an overview of the 2025 conditions. This section will describe the environmental policy starting point, including a brief description of the IRA provisions as well as their expected emissions reduction effects, fiscal cost, and implementation issues. This section will also describe the fiscal policy starting point, which features rising interest rates, deficits, and debt, alongside the looming TCJA expirations and Social Security and Medicare

[1] EPRI
[2] UCLA School of Law, NBER
[3] Federal Reserve Bank of Minneapolis
[4] Harvard University, NBER
[5] MIT Sloan, NBER

insolvency issues. Finally, this discussion will set US climate policy in a larger global context, discussing sources of tension as well as future opportunities for greater policy alignment.

Section 3: This section will briefly describe principles of climate policy reform, focusing on emissions reduction, efficiency metrics, revenue needs, distributional considerations, and global policy spillover issues.

Section 4: This will be the main analytical contribution of the paper. Within this section, a menu of climate policy choices will be modelled and discussed. Analysis will address emissions impacts, fiscal impacts, effects on household budgets, and larger macroeconomic and distributional effects. This section will use EPRI's U.S. Regional Economy, Greenhouse Gas, and Energy (US-REGEN) model, which includes regional disaggregation and technological detail of the power sector and energy systems.[6]

In our policy menu, we focus on key climate policy options that may be part of the national conversation in 2025. We include both proposals that would rank well in terms of the policy criteria outlined in Section 3 as well as other options that would rank less well by such criteria but that might nonetheless be proposed.

We begin with a reference scenario with current policies, regulations, and incentives. We then consider the following options, which could potentially be passed under reconciliation:

A. **Repeal the Inflation Reduction Act**
   The Republican-controlled House of Representatives has already made efforts to repeal the IRA.[7] Our modeling will assume that all the climate-related provisions are zeroed out and are not replaced by anything similar.
B. **Expand the Inflation Reduction Act**
   Given that, even with the IRA, projected 2030 emissions still fall short of the Paris commitment, some legislators might seek to expand the IRA tax credits to meet emissions goals. This scenario provides a useful point of comparison for the emissions reductions and fiscal impacts of the broad carbon fee scenario below.
C. **Broad carbon fee with carve-outs**
   A broad carbon fee would generate revenues and potentially drive additional emissions reductions, even with the IRA in place. We consider a modest fee that would carve out retail gasoline in order to insulate households. We plan to model a fee that starts at \$15/t-CO_2 in 2027, rising to \$65 over ten years, at first slowly, and then more steeply, after which it rises with inflation. We may also consider other price-path options or dials to this proposal.
D. **Industry-only carbon fee**
   A more limited carbon fee that only covers emissions in a select group of upstream industries may be more politically palatable; coupling this proposal with a Carbon Border Adjustment Mechanism (CBAM) could allow proponents to cast the proposal solely in

[6] Detailed model documentation and recent peer-reviewed articles can be found https://esca.epri.com/.
[7] These efforts have also led to updated JCT estimates of the IRA tax credits, as scores for repealing them. See, e.g. JCT's estimate of repealing many IRA provisions under the Limit, Save, Grow Act, JCT's score of amendments that would repeal IRA provisions, and JCT's score of the Build It In America Act.

terms of competitiveness goals. We consider a fee that covers direct and electricity-related emissions from the iron and steel, aluminum, fertilizer, cement, and chemical industries.

E. Clean Electricity Standard
We would consider a federal program that incentivizes 100% clean electricity. The program would use fees and monetary rewards for the electric utilities and other load-serving entities based on their emissions relative to a prior period benchmark. Our base case assumes full compliance.

F. Selective repeal of IRA coupled with carbon fee with carve-outs
A divided government may also act on climate as part of the overall compromises surrounding the tax code. We consider a scenario that involves a selective repeal of certain provisions of IRA together with a carbon fee.

For these proposals, one key table would compare the policy options in terms of outcomes that would include emissions reductions and fiscal effects. Other analysis would consider effects on household budgets, and the consequences of these policies for the distribution of income as well as macroeconomic outcomes.