

Fiscal consolidation and climate policy: An overlapping generations perspective

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Abstract

This paper examines the distributional and efficiency impacts of public debt consolidation financed through a carbon tax employing a dynamic general-equilibrium model with overlapping generations of the U.S. economy. The numerical model features government taxes and spending and a multi-sectoral production structure including intermediate production, specific detail on the energy sector both in terms of primary energy carriers and energy-intensive industries, and sector- and fuel-specific carbon inputs. In contrast to revenue-neutral carbon tax swaps, using the carbon revenue for deficit reduction implies a relaxation of future public budgets as debt repayment results in lower future interest obligations. While intergenerational welfare impacts depend importantly on what tax recycling instrument is used, we find that combining public debt consolidation with a carbon policy entails the possibility of sustained welfare gains for future generations. If social discount rates are sufficiently low or if social preferences exhibit a large aversion with respect to intergenerational inequality, combining fiscal consolidation and climate policy may offer the chance for societal gains even without considering potential benefits from averted climate change.