



“Summary of article by M. Jeff Hamond, Stephen J. DeCanio, Peggy Duxbury, Alan H. Sanstad, Christopher H. Stinson: An Idea Whose Time Has Come” in Frontier Issues in Economic Thought, Volume 6: A Survey of Sustainable Development. Island Press: Washington DC, 2001. pp. 313-315

Social Science Library: Frontier Thinking in Sustainable Development and Human Well-being

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There has been a great deal of discussion regarding the use of fiscal policies to encourage environmental conservation, and many such tax policies have been implemented at the local level in the United States and in some European countries. While such proposals take many forms, the premise of most is that government should tax more heavily those activities it most wants to discourage and tax less heavily the behaviors it wants to promote. These two chapters argue that to those ends government should reduce taxes on labor, innovation, and capital formation and replace those revenues with new taxes or fees on pollution and waste. Such a change could be called a “resource-based tax shift.”

The Tax-Shift Concept

The United States faces many long-term problems that a resource-based tax shift could help solve. Among them are high payroll taxes, expanding entitlement programs, global climate change and limited economic opportunity in inner cities. A revenue-neutral tax shift can be designed which is also neutral in its impact on income distribution and which encourages environmentally sound practices. Such a tax shift could involve new taxes or auctioned emission permits, but the impact would be similar. This approach could gain support across the political spectrum “and potentially create incentives for more investment in both human and physical capital – an economic stimulus package with no revenue cost.” (2)

“The current tax system sends the wrong signals to virtually everyone. It discourages work, enterprise, and capital formation while it encourages sprawl, pollution, waste, and the inefficient use of resources.” (2) Through its taxation policies, government chooses what to tax and what not to tax, or tax at a significantly reduced rate. When government wants to promote a social goal, such as investment in inner cities, one of the tools it currently uses is reducing taxes, usually in the form of tax breaks, on such activities. Such principles can also work as they relate to the environment. Often, the tax debate has come down to a conflict over how much of the tax burden is borne by labor and how much by capital, with the tax burden often shifting from one to the other. Higher taxes on capital can discourage savings and investment, while raising taxes on labor discourages work. But a society where we value both labor and entrepreneurship, this trade-off is not productive.

“Why not develop a socially useful tax system that would tax those things the country needs less of, and untax those things of which society wants more?” (3) It is reasonable to suggest that government could reduce taxes on payroll, individual income, and corporate profits while raising taxes on environmentally destructive practices. We could tax carbon dioxide emissions, air and water pollution, or overconsumption of virgin materials. “While such a shift from taxing ‘goods’ – the creation of wealth through labor and investment – to ‘bads’ – the depletion of wealth through pollution and environmental degradation – cannot be a magic bullet for every economic and environmental ill, it does offer a promising chance for promoting work and investment while moving toward market-based policies that would be an improvement over the current regulatory structure.” (3)

Such proposals have foundered in the United States for a number of reasons. They have often been offered as tax increases, rather than revenue-neutral proposals. The business community has often opposed such taxes for this reason. Some proposals have been criticized for being regressive, increasing the tax burden on the poor. Critics have also argued that such policies are risky, as they haven’t been tried before. This proposal addresses all such concerns because it is both revenue-neutral and distributionally neutral, and it is now based on the successful experiences in many countries with such “green taxes.” (See box.)

Economic and Environmental Impact

There are several compelling rationales for such a tax structure. First, it restores legitimacy to public finance, imposing the logic that people should keep more of what they earn but should pay more heavily for costs they impose on others. This gives a coherent rationale to our beleaguered tax structure, restoring the notion that future generations should not bear the costs of today’s actions. It allows the public to benefit from revenues collected on publicly owned resources. And it empowers people to reduce their own taxes by engaging in environment-friendly activities – buying energy-efficient vehicles, homes, and equipment, for example.

The economic and fiscal rationales for a tax shift are also compelling. It could reduce inefficiencies in the tax system, stimulating growth. It could incorporate the now-unaccounted externalities of social and environmental costs into prices, making the economy as a whole more efficient. It would promote greater efficiency, because any pollution or waste is an example of an input purchased that is then not used to create a product or a service. And lowering taxes on individuals, to stimulate work, savings, and investment, is an attractive goal.

Finally, the environmental rationale is that it could “provide a least-cost approach to reducing pollution, waste, and the long-term threat of climate change.” (5) There are three principal benefits of such a tax shift. The first is averting long-term environmental damage from climate change and pollution. With estimated annual global costs of global warming of between \$270 billion and \$316 billion, it is imperative that we find ways to reduce carbon emissions.¹ Carbon taxes or tradable permits could raise significant revenues while encouraging the switch to cleaner sources of energy. Other forms of pollution also have long-term costs; acid rain from air pollution reduces productivity and increases public health costs.

Second, an efficient tax on common property resources such as the atmosphere will help conserve such resources by raising the costs of polluting. A resource tax can reduce or eliminate low-value uses of this resource, promoting conservation while providing tax revenues to further the goals of society as a whole.

Third, there are many cases where relatively inefficient government pollution-control regulations could be eliminated in favor of resource taxes, a market-based approach to environmental control. Higher gas prices, for example, would be a more efficient way to achieve fuel efficiency than the enforcement of federal fuel efficiency standards. An increasing number of countries are experimenting with such approaches, including Germany, Chile, and several Scandinavian countries. The United States should follow their lead.

Notes

1. Bruce, James P., Hoesung Lee, and Eric F. Haites, eds 1996. *Climate Change 1995: Economic and Social Dimensions of Climate Change*. Contribution of Working Group III to the Second Assessment Report of the Intergovernmental Panel on Climate Change. Cambridge, United Kingdom: Cambridge University Press.