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The Green Tax Shift / By Fred Foldvary

Milton Friedman famously said that there is no such thing as a free lunch. But when it comes to pollution, we're still not asking those responsible to pick up their own tab. Instead, we could promote sustainable economies by reducing climate-changing pollution with minimal economic cost—and, indeed, even with an economic gain. How? A "green tax shift."

Simply put, a green tax is a levy on pollution. It goes further than a carbon tax to levy a charge on all harmful emissions in proportion to the damage they cause, ideally making polluters pay for the full social cost of their emissions.

The green tax shift replaces taxes on income and goods with taxes on pollution. Such environmental taxes are already levied in Germany, the Netherlands, and France for discharges into rivers and lakes, and they have greatly reduced water pollution even amidst the large chemical industry of western Germany. In the United States, a few states have very limited emissions levies.

Some economists and policy makers have claimed that the cost of investing in emission-reducing technology and production methods needs to discount the effect on future generations, since wealth today is worth more to us than wealth in the future. Others dispute such discounting as not valid, saying we have no moral right to declare future lives as less valuable than present-day lives. The green tax shift would make the question of social discounting moot, as pollution charges would reduce present-day emissions and benefit those living today as well as those living in the future.

Unfortunately, recent reports and legislation addressing global warming have not focused on pollution charges. Instead, they promote methods that would impose large costs on society and therefore prevent a swift shift to policies that would create environmentally sustainable economies.

Regulation is not the answer

The Stern Review of the Economics of Climate Change predicts economic damage of up to 20 percent of global income and proposes emissions trading as a key remedy, as well as reducing the destruction of forests. The Intergovernmental Panel on Climate Change, established by the World Meteorological Organization and the United Nations Environment Program, proposes regulations, emissions trading, and environmental taxes. And in September 2006, California Governor Schwarzenegger signed legislation (AB 32) to reduce the state's greenhouse gas emissions, implementing a combination of increasing regulations (mandatory emissions caps) and emissions trading.
Both restrictive regulations and emission permits impose costs on enterprise. Regulations impose a uniform cost on production that disregards individual costs and benefits. For example, regulations requiring gasoline additives make gasoline more expensive and can have bad unintended consequences, such as the contamination of groundwater by the MTBE added to gasoline in California. Caps on emissions can create large costs on some producers, which becomes multiplied into a larger social cost of unemployment as industries shut down or move away.

Tradable permits, implemented by several states, are more efficient than regulations. The European Union Emission Trading Scheme, initiated in 2005, operates in 25 EU member countries. With a fixed number of permits, any increase in pollution requires a firm to buy permits from firms holding them, but that creates higher costs for the buyers and windfall profits for the firms holding permits, with no gain to society from those profits. Moreover, the government would have to buy back permits if the market price of permits is not high enough to reduce pollution to the desired level.
In contrast, a revenue-neutral green tax shift would create net benefits to industry. Current taxes on wages, profits, and the sale of goods have a "deadweight loss," a waste of resources caused by the added costs, which reduces sales, output, and investment. The reduction in output from the emissions taxes is offset by the increase in output from eliminating taxes on income and sales. A complete green tax shift goes even further to shift taxation also to land values, which enables an even greater or

complete elimination of taxes with excess burdens, since a land tax has no deadweight loss, land being a natural resource that does not shrink, hide, or flee when taxed.

Time to pay the piper

Environmentalists are promoting benevolent efforts such as a sustainability pledge to reduce the use of electricity, gasoline, and meat. The intention is praiseworthy, and these endeavors help educate people. Voluntary efforts to save energy, eat organic food, and waste less paper are nice, too. But the total effects of such programs are likely to be small compared to the global problem, and there seems to be very little attention to the policy changes needed to confront the issue on a global scale.

Some groups, such as the Sierra Club, focus on excessive consumption as the problem. But if resources were properly priced to include the pollution costs, as producers passed on the pollution charge to their customers, consumption as such would not be a social problem. The problem today is that producers and consumers like car drivers do not pay for the environmental social costs of their activity.
In a truly free market, government neither penalizes nor subsidizes production and consumption. If polluters do not compensate society for the damage they cause, they are in effect subsidized. A pollution charge prevents this subsidy. The green tax shift is therefore ethically right and good for the economy as well as the environment.

Photo: Charles Barry

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