

Commentary
by Larry Goldstein
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IF AND WHEN THE BAT BREAKS

On Finding Revenues for Tax Reform

Both the Trump Administration and the Republican majority in the Congress are engaged in a series of policy initiatives to promote higher rates of economic growth for the national economy. A central piece of the pro-growth initiative is tax reform, specifically lowering rates for individuals across the board, and more importantly, lowering the corporate tax rate so U.S. companies are competitive with our major trading partners. Corporate income taxes represent approximately 10% of total federal receipts, varying from \$300 billion to \$344 billion from 2014 to 2016.

Tax reform is essential to restore growth, but it is also expensive. To pay for tax reform, the leadership in the House of Representatives is proposing a border adjustment tax or BAT. The BAT seeks to adjust the difference between the lower taxes on the production of goods and services in internationally traded goods among many of our trading partners vs. the higher cost structure faced by U.S. firms.

The reason for this difference is many of our trading partners raise more of their revenue from value added taxes (VAT) instead of corporate taxes. This places U.S. firms at a disadvantage as goods sold both domestically and abroad face the same tax cost structure, much of it tied to the relatively high U.S. corporate tax rate. The proposed remedy is to place a tax on all imported goods, lower the corporate tax rate, and remove all taxes on exports. However, considerable opposition to this tax is already underway among firms with substantial imports (retailers, many refiners, etc.) and substantial opposition to the BAT is likely in the Senate, even if it is likely to pass the House.

There are, of course, other means to raise revenues needed to support a cut in corporate income taxes. In the last few weeks a group of Republican luminaries have proposed the implementation of a tax on emissions of carbon dioxide as a combined market based strategy to reduce U.S. emissions of carbon dioxide (CO₂) and as a substantial revenue raiser. The proponents of the tax include former Secretaries of State James A. Baker III and George P. Shultz, and M. Paulson Jr., a former secretary of the Treasury. Even Greg Mankiw, former Chair of the Council of Economic Advisors under President George W. Bush has put his substantial influence in support of the tax. The supporters point out that the tax is a more efficient method for curtailing carbon emissions than regulatory programs and in fact recommend that carbon control regulations be fully repealed if the tax is implemented. Their plan has been presented to the White House, but it apparently has not received much support.

Carbon dioxide (CO₂) is not a typical criteria pollutant. It is a colorless and odorless gas, essential for life on the planet. It is also not a local pollutant such as sulfur dioxide, lead, particulates, or volatile organic compounds. Concern over controlling carbon is related to the view that rising concentrations of CO₂ in the atmosphere does long term harm to the world climate. A carbon emission anywhere is an emission everywhere.

Note that despite steady growth in the U.S. GDP, CO₂ has been on a steady decline not only relative to the size of our economy but in absolute terms as well. According to the U.S. Energy Information Agency (EIA) we can expect continued reductions in CO₂ emissions from the U.S. well into the future. Growth in electric power generation will be modest and renewable fuels continue to make considerable headway. At the same time CO₂ emissions outside the U.S. are projected to see sustained growth. Future growth in carbon emissions will come from Asia,

dominated by the growing industrial base and population growth in China and India.

Given that CO₂ emissions are a global concern, and in fact reductions can only be effective through participation of all the world's major emitters, any U.S. policy to increase costs on our national economy must be evaluated in terms of U.S. competitiveness. If we increase our costs of production, and other major emitters do not take action, our economy will be less competitive than our major trading partners. This is why what is happening in China and India is very important. A unilateral carbon tax in the U.S would run counter to our attempt to place U.S. industries on an equal playing field with our competitors if they are not undertaking similar control measures.

An alternative to a carbon tax, yet a very efficient revenue raiser, would be an increase in the federal gasoline tax. A smaller increase in the tax of other transportation fuels could be considered as well. The gasoline tax has not been increased since 1993. If it were adjusted solely for changes in inflation since then, it would be higher by 75 percent.¹ For example, an annual increase of 10 cents/gal, 40 cents over 4 years would raise \$300 billion over 10 years, even if you rebate the increase to the lowest 10% of wage earners. The rebate would address the central concerns that an increase in gasoline is regressive and harmful to the poor. A higher gasoline tax would encourage conservation and reduce congestion. It would increase the relative competitiveness of alternative fuels. It would send a signal to consumers to factor in the higher future cost of gasoline when contemplating a purchase of a new vehicle and would allow the market to drive fuel efficiency instead of regulations. Further, in the current economic climate if the federal government doesn't proceed with an increase in gasoline taxes, the states will fill the vacuum and raise their own gasoline taxes. In fact, several states have already announced substantial increase in gasoline taxes with little opposition.

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¹In 1993 the average family car might have averaged 15 mpg. If they drove 10,000 miles they used 667 gallons and paid \$ 122.73 in federal taxes. In 2017 if the average is 25 mpg and if the same family drove 12,000 miles the consumption would have dropped to 480 gallons and federal gasoline tax collections would have fallen to \$88.32, a decline of over 30% in nominal revenues.

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