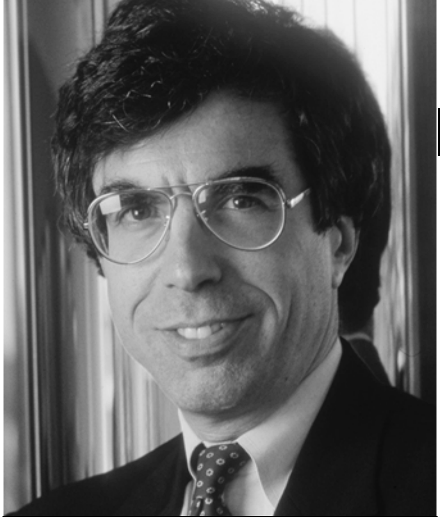

By Robert N. Stavins

A Tale of Two Taxes, A Challenge To Hill

Whether they are called "revenue enhancements" or "user charges," fear of the political consequences of taxes restricts debate on energy and environmental policy options in Washington. During the presidential campaign the two candidates presented very different energy strategies, including a number of laudable goals and proposals, but there was no mention in either package of the one element of a comprehensive strategy that most participants in Washington discussions privately endorse and might ultimately support: a higher tax on gasoline. Here is something for the Congress to consider, because if there is ever an opportunity for creative thinking on Capitol Hill that goes against the conventional wisdom, surely it is during the early days of a new Congress.

A gas tax increase — coupled with an offsetting reduction in other taxes, such as the Social Security tax on wages — could make most American households better off, while reducing oil imports (read dependence on Middle Eastern regimes), local pollution, urban congestion, road accidents, and global climate change. This revenue-neutral tax reform would exemplify the market-based approaches to environmental protection and resource management I examined in previous columns.

Such a change need not constitute a new tax, but a reform of existing ones. It is well known — both from economic theory and numerous empirical studies — that taxes tend to reduce the extent to which people undertake the taxed activity. In the United States, most tax revenues are raised by levies on labor and investment; the resulting reduction in these fundamentally desirable activities is viewed as an unfortunate but unavoidable side-effect of the need to raise revenue for government operations. Would it not make more sense to raise the revenue we need by taxing undesirable activities, instead of desirable ones?

Combustion of gasoline in motor vehicles produces local air pollution as well as carbon dioxide that contributes to global climate change, increases imports of oil, and exacerbates urban highway congestion. Can anyone really claim that — given a choice between discouraging work and discouraging gasoline consumption — it is better to discourage work?

According to the U.S. Department of Energy, a 50-cent gas tax increase could eventually reduce gasoline consumption by 10 to 15 percent, reduce oil imports by perhaps 500,000 barrels per day, and generate about $40 billion per year in revenue. Furthermore, this approach would be far more effective than ongoing proposals to increase the Corporate Average Fuel Economy standards, which affect only new cars (not trucks or other vehicles) and lead to serious safety problems by encouraging automakers to produce lighter vehicles. Remember that a major effect of CAFE standards has been to accelerate the shift from cars to SUVs and light trucks (so that overall fuel efficiency of new vehicles sold is no better than it was a decade ago, despite the great strides that have taken place in fuel efficiency technologies). As my Harvard colleague Martin Feldstein pointed out in *The Wall Street Journal* in 2001, the conventional approach "does nothing to encourage individuals to drive less, to use their cars more efficiently, or to shift sooner to new and more fuel efficient [and cleaner] vehicles." A more enlightened approach — a market-based approach — would reward consumers who economize on gasoline use. And that is what a revenue-neutral gas tax is all about.

The revenue from the gas tax could be transferred to the Social Security Trust Fund and credited to current workers. If $40 billion per year from new gas tax revenues were transferred to Social Security, the payroll tax — the employee contribution to Social Security — could be cut by perhaps a third: a worker with annual wages of $30,000 would take home an additional $750 per year! The extra income would more than offset the cost of the gas tax, unless the worker drove over 35,000 miles per year in a car getting 25 miles or less per gallon. Rebating the gas tax in this way addresses the greatest concern about higher gas taxes — that they can hit hardest those workers who drive to their jobs. Further, a tax of this magnitude could be phased in gradually, perhaps no more than 10 cents per year over 5 years, allowing individuals and firms to adjust their consuming and producing behavior.

Proposals for gasoline tax increases in the last Congress would have dedicated the revenue to public spending (for transportation and other programs). A key difference is that the proposal I have outlined here is for a revenue-neutral change in which the gas tax revenue would be returned to Americans through reduced payroll taxes. To adopt some of the language I developed in my previous columns, such a change can be both efficient and equitable, and — for those reasons — perhaps even politically feasible.

Of course, such a scheme is not a panacea for U.S. energy and environmental problems. But it would make a significant contribution if enacted. On the other hand, political fear of the T-word in Washington means that it may never even be discussed in public, let alone adopted. Most fear of taxes is due to politicians' anxieties about asking their constituents to pay more. But an increase in the federal gas tax, rebated through reduced payroll taxes, would not cost most Americans any more *and* would have significant long-term benefits for the country. Still, the T-word looms large; maybe it should be called an "All-American Ecologically Sound, Fully Recyclable, Anti-Terror, Energy-Independence Assessment."

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