Comments for the Record
House Ways and Means Committee
Subcommittee on Select Revenue Measures
Subcommittee on Oversight
Joint Hearing on Energy Tax Policy and Tax Reform
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Chairmen Tiberi and Boustany and Ranking Members Neal and Lewis, thank you for the opportunity to submit comments for the record on these issues.

There are three aspects to consider regarding whether energy policy should be conducted through the tax code: energy taxes as transportation user fees; energy taxes as environmental sin taxes and energy tax policies as a subsidy for business. How to design provisions for a sustainable energy policy and tax reform will be discussed for each of these areas and we will address certain oversight questions on whether current tax provisions have been implemented efficiently and effectively, although we will leave most of the latter analysis to the scheduled witnesses, as well as analysis of H.R. 1380, the NAT GAS Act.

Energy Taxes as Transportation User Fees

The most familiar energy tax is the excise tax on gasoline. It essentially functions as an automatic toll, but without the requirement for toll booths. As such, it has the advantage of charging greater tolls on less fuel efficient cars and lower tolls on more efficient cars, all without requiring purchase of a EZ Pass or counting axles.

It is a highly efficient tax in this regard, although its effectiveness is limited because it has not kept pace with inflation. This could be corrected by shifting it from a uniform excise to a uniform percentage tax – however because the price of fuel varies by location, there may be constitutional problems with doing so. The only other option to increase this tax in order to overcome the nation's infrastructure deficit – which is appropriately funded with this tax – is to have the courage to increase it.

In this time of high unemployment, such an increase would be a balm to economic growth, as it would put people back to work. Given the competitive nature of gas prices, there is some question as to whether such an increase would produce a penny for penny increase in gasoline prices. If the tax elasticity is more inelastic than elastic, the tax will be absorbed in the purchase price and be a levy on producers. If it is more elastic, it will be a levy on users and will impact congestion (and thus decrease air pollution and overall conservation). For many citizens, either prospect is a win-win, given concerns over both climate change and energy industry profits. The only real question is one of the political courage to do what is necessary for American jobs and infrastructure –and that seems to be a very open question.

Energy taxes are currently levied through the private sector, rather than through toll booth employees, which from the taxpayer point of view is a savings as it externalizes the pension and benefit requirements associated with hiring such workers.

In the event that gasoline cars were replaced with electric cars, given either improvements in battery charging technology or in providing continuous supply through overhead wires, much in the same way that electric trains and busses receive power, any excise per kilowatt for the maintenance of roads could be collected in the same way – or the road system could be made part of a consortium with energy providers, car makers and road construction and maintenance contractors – effectively taking the government out of the loop except when eminent domain issues arise (assuming you believe such a tool should be used for private development, we at the Center believe that it should not be).

The electric option provides an alternative means to using natural gas, besides creating a gas fuelling infrastructure, with natural gas power plants providing a more efficient conduit than millions of internal combustion engines. The electric option allows for the quick implementation of more futuristic fuels, like hydrogen, wind and even Helium3 fusion. Indeed, if private road companies become dominant under such a model, a very real demand for accelerated fusion research could arise, bypassing the current dependence on governmental funding.

In the event of comprehensive tax reform, the excise for fuel would be either a component of or an addition to any broad based Value Added or VAT-like Net Business Receipts Tax. The excise should not disappear into such a general tax, as doing so would have the effect of forcing all businesses to fund transportation on an equal percentage, regardless of their use of such infrastructure. Of course, like a VAT, any gasoline excise would be accounted for using the credit receipt method, so that cascading taxes would not occur, as they do now with this excise functioning as hidden levy.

Energy Taxes as Environmental Sin Taxes

Carbon Taxes, Cap and Trade and even the Gasoline Excise are effectively taxes on pollution or perceived pollution and as such, carry the flavor of sin taxes. As such, they put the government in the position of discouraging vice while at the same time trying to benefit from it. Our comments above as to whether the tax elasticity of the gasoline excise has an impact on congestion and pollution is applicable to this issue, although tax inelasticity will mute the effect of discouraging “sinful” behavior and instead force producers to internalize what would otherwise be considered externalities – provided of course that the proceeds from these taxes are used to ameliorate problems of both pollution (chest congestion) by paying for health care and traffic congestion in building more roads and making more public transit available – while funding energy research to ease the carbon footprint of modern civilization.

Oddly enough, this approach was once considered the conservative alternative to other more intrusive measures proposed by liberals, like imposing pollution controls on cars and factories or simply closing down source polluters. When those options are taken off the table, however, or are considered impractical, then the concept of environmental sin taxes becomes liberal and no action at all becomes the conservative position.

These use of environmental sin taxes is by nature much more efficient economically than pollution controls and probably also more efficient than allowing producers and consumers to benefit from externalities like pollution, congestion and asthma. As with transportation funding, such taxes are only effective if they actually provide adequate funding for amelioration or otherwise change consumer behavior. If the politics of the day prevent taxes from actually accomplishing these objectives, then their effectiveness is diminished.

The short term political win of keeping taxes too low can only work for so long. Reality has a way of intruding, either because infrastructure crumbles, congestion becomes too high, children become ill with asthma (for full disclosure purposes, I suffered from this after moving down-wind as a child from an Ohio Edison coal plant) and sea levels rise – destroying vacation homes and the homes of those who support them – and if Edgar Cayce is to be believed – the states that are the heart of the Republican base.

The role of energy taxes as sin taxes are preserved in comprehensive tax reform only if they are preserved in addition to value added and net business receipts taxes. If there is no separate tax or higher rate for these activities, there is no sin tax effect and the "sin" is effectively forgiven with any amelioration programs funded by the whole of society rather than energy users.

Oddly enough, because the Center does not mention carbon taxes or cap and trade in our standard proposal, liberal commentators on Daily Kos criticize its lack and assume we don't believe in them at all. This is far from the case, as our proposals say nothing about replacing such taxes with our proposed VAT and NBRT. Our proposal is to replace low and mid rate income taxes, corporate income taxes and non-OASI payroll taxes with these revenues. We simply don't touch the question of any other excise. This shows how much the fortunes of energy taxes have changed since Vice President Gore suggested their inclusion in President Clinton's tax proposals.

Energy Tax Policies as a Subsidy for Business

There are quite a few ways in which energy tax policy subsidizes business. The most basic way is the assessment of adequate energy taxes, or taxes generally, to pay for government procurement of infrastructure and research. If tax reform does not include adequate revenue, the businesses which fulfill these contracts will be forced to either reduce staff or go out of business. Government spending stimulates the economy when more money is spent because taxes are raised and dedicated (or even earmarked) for these uses. Eliminating specific energy taxes in tax reform forces this work into competition with other government needs.

Let me be clear that the Center does not propose such a move. Our approach actually favors more, not less, identification of revenues with expenditures, reducing their fungibility, with the expectation that taxes increase when needs are greater and decrease when they are met, either through building in advance of need or finding an alternative private means of providing government services.

The more relevant case to Committee's question is the existence of research and exploration subsidies as they exist inside of more general levies, such as the Corporate Income Tax. To the extent to which tax reform eliminates this tax and replaces it with reforms such as the Net Business Receipts Tax (which taxes both labor and profit), such subsidies are problematic, but not impossible to preserve.

This is one of the virtues of a separate Net Business Receipts Tax, rather than replacing the Corporate Income Tax with a VAT or a Fair Tax – which by their nature have no offsetting tax expenditures. The challenge arises, however, when the existence of such subsidies carry with them the very justified impression that less well connected industries must pay higher taxes in order to preserve these tax subsidies. Worse is the perception, which would arise with their use in a business receipts tax, that such subsidies effectively result in lower wages across the economy. Such a perception, which has some basis in reality, would be certain death for any subsidy.

One must look deeper into the nature of these activities to determine whether a subsidy is justified, or even possible. If subsidized activities are purchased from another firm, the nature of both a VAT and an NBRT alleviate the need for any subsidy at all, because the VAT paid implicit in the fees for research and exploration would simply be passed through to the next level on the supply chain and would be considered outside expenditures for NBRT calculation and therefore not taxable. If research and exploration is conducted in house, then the labor component of these activities would be taxed under both the VAT and the NBRT, as they are currently taxed under personal income and payroll taxes now.

The only real issue is whether the profits or losses from these activities receive special tax treatment. Because profit and loss are not separately calculated under such taxes, which are essentially consumption taxes, the answer must be no. The ability to socialize losses and privatize profits through the NBRT would cease to exist with the tax it is replacing.

If society continues to value such subsidies, they would have to come as an offset to a carbon tax or cap and trade regime, if at all, as the excise tax for energy is essentially a retail sales tax and the industrial model under which the energy industry operates insulates the gasoline excise from the application of any research and exploration credits. If the energy companies were to change their model to end independent sales and distribution networks and treat all such franchisees as employees (with the attendant risk of unionization), then the subject subsidies could be preserved – provided that the related energy tax is increased so that the subsidy could actually operate – favoring those who participate in research and development and penalizing those who do not.

In other words, if big oil wants to keep this subsidy when there are no corporate income tax, it must buy up all its franchisees and allow the government to double the gasoline tax with a deduction at payment for research and exploration.

Without taxes, there can be no subsidy.

The last subsidy issue involves the use of a Value Added Tax as an oil import fee. If the VAT replaces some percentage of current employee and investor income taxes, domestically produced energy products become more competitive on the world market, provided that the VAT is border adjustable, which it would be. For example, if Alaska crude is shipped to Japan for refining and use or western low-sulfur coal is shipped to China, it would be cheaper than the same product shipped under today's tax system.

The NBRT would not be border adjustable because it is designed to pay for entitlement costs which benefit employees and their families directly, so that it is appropriate for the foreign beneficiaries of their labor to fund these costs. Additionally, the ultimate goal of enacting the NBRT is to include tax expenditures to encourage employers to fund activities now provided by the government – from subsidies for children to retiree health care to education to support for adult literacy. Allowing this tax to be zero-rated at the border removes the incentive to use these subsidies, keeping government services in business and requiring higher taxation to support the governmental infrastructure to arrange these services – like the Committee on Ways and Means.

Thank you again for the opportunity to present our comments. We are always available to discuss them further with members, staff and the general public.

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This testimony is not submitted on behalf of any client, person or organization other than the Center itself, which is so far unfunded by any donations.