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Clinton's Btu Tax: All Costs, No Benefits

As part of his deficit reduction package President Clinton is proposing a Btu (British thermal unit) tax, based on the heat generating capacity of different fuels. The stated purposes of the tax are to raise revenue for deficit reduction, encourage energy independence, and promote environmental quality. In reality the tax would penalize the consumption and production of all forms of energy and would have adverse consequences for every U.S. citizen. While the costs of this measure would certainly be heavy and widespread, the benefits to society are likely to be non-existent.

The Btu tax would impose penalties on the use of all energy sources with a disproportionately heavy penalty on the use of oil. The basic rate applied to most fuels would be 25.7 cents per million Btu's. There would be an additional 34.2 cents per million Btu's generated by oil based fuels, with an exception for residential home heating oil which would be taxed at the lower 25.7 cents. In terms of the per unit effect of the tax on major fuels, the Btu tax would translate into \$5.57 per short ton of coal, \$.26 per mcf (million cubic feet) of natural gas, \$1.50 per barrel of oil used for home heating oil, and \$3.24 per barrel of oil used for refined petroleum products such as gasoline. These rates

would be phased in, in equal annual increments, between July 1, 1994, and January 1, 1998. Beginning in 1998, they would be indexed to the inflation rate, virtually guaranteeing annual increases in the tax.

The Economic Impact

This energy tax...is...important...to reduce the deficit, create the conditions to restore long term growth to our economy, and create the jobs and income growth Americans want. (Treasury Secretary Lloyd Bentsen, 4/20/93)

Contrary to Secretary Bentsen's assertion, the economic effects of the Btu taxes would all be negative. Energy is an essential input into every production process and the operation of every household. As such, the Btu tax would raise everyone's cost of living both directly and indirectly, without regard to income. The prices that people pay for heating and cooling their homes, operating their electrical appliances, and driving their cars would all go up. Beyond the direct increase in energy costs, the Btu tax would result in higher prices than otherwise would be experienced for every product on the market. This is because the production of every good and service in the economy requires energy as an input.

The increase in production costs generated by the tax would result not only in higher prices for goods and services but also in overall reductions in productive output. Again, contrary to Secretary Bentsen, higher production costs would translate into a reduced demand for labor and capital services with adverse consequences for the overall unemployment rate and the rate of growth in individual and family incomes. Furthermore, to the extent a reduction in energy inputs causes labor to be less productive, there would be additional adverse consequences for wage rates.

There is a trade-off between the growth of government and economic growth. By proposing the Btu tax, President Clinton has indicated he prefers the former to the latter.

Since all individuals, sectors of the economy, and regions of the country do not consume energy proportionately, the President's proposed Btu tax would be discriminatory. Transportation, agriculture, and public utilities would be hit particularly hard. Due to the heavy surtax on oil, the airline and trucking industries, both dependent on gasoline, would also pay a disproportionate share of the Btu tax bill. Also, the more energy intensive manufacturing sector would be disproportionately harmed, causing reallocations of productive activity toward services. Similar problems would be suffered by workers and consumers living in sparsely populated areas of the West, mid-West, and South, who drive relatively long distances to work, school, and shopping areas. Clinton's Btu tax would clearly penalize rural families relative to urban dwellers.

While several reasons are given for imposing the Btu tax, as indicated by Secretary Bentsen, primarily it is advocated to reduce the deficit, and therefore enhance economic growth. Ultimately, though, it should be viewed, along with the other new taxes in the Clinton economic plan, as a way to finance new spending. The reason why new taxes are needed at all is because the President wants to increase federal spending. Under the President's budget proposal, government spending would increase by nearly \$385 billion over five years (FY 1994-1998). In the absence of any new taxes, it is estimated that revenues to the Treasury would increase by nearly \$305 billion over the same time period. This means that if spending were frozen at current levels, the deficit would automatically fall by an amount equivalent to the increased revenues over the period. This would be done without any of the detrimental effects of new or higher taxes. Indeed, any increase in spending short of \$305 billion over the period could be sustained within the context of deficit reduction. Therefore the "need" for new taxes should be associated not with deficit reduction but with increases in the size and scope of the federal budget.

Secondary arguments for the Btu tax are related to issues of energy independence, conservation and efficiency, and improving environmental quality. Assuming, for the moment, that reducing our relative use of imported energy sources, such as oil or natural gas, should be a public policy goal, the Btu tax proposal would not produce this result. The tax is not

higher on imported energy sources than it is on domestic sources. Because of this, reductions in the consumption of oil and gas would not be weighted disproportionately toward imports. Imports of foreign oil would decline but not relative to overall oil usage and only because of general reductions in economic output. Beyond this, though, American users of energy should be allowed, indeed encouraged, to purchase their energy from the least expensive suppliers, wherever they are located. Public policy to promote greater reliance on domestic sources for its own sake makes no sense. The 1990 invasion of Iraq by Kuwait and the subsequent embargo of oil from those countries was a perfect demonstration of how unregulated markets can efficiently adjust to politically induced disruptions in the flow of foreign oil.

It is also argued that the Btu tax would promote "energy efficiency" and conservation. This assertion is false. More efficient energy use implies that fewer energy inputs are used per unit of output. Indeed, the United States is already very energy efficient in this economically meaningful sense. The ratio of energy use per dollar's worth of gross domestic product fell by 21 percent during the decade of the 1980s. The Btu tax, on the other hand, would decrease energy usage simply because the economy would be producing less. While efficiency typically means getting more for less, the Btu tax would translate into getting less for less. There is no reason for using less energy for its own sake.

While the Btu tax is touted as a tool of environmental policy, support for this argument has not been forthcoming. The only concrete pollution problem to which the tax is specifically addressed, and then only in general terms, is the global warming problem that allegedly could result from carbon dioxide (CO₂) emissions. But climatological records show that enhanced levels of carbon dioxide in the atmosphere have not led to higher global temperatures. Indeed many scientists are now suggesting that increased CO₂, essential for plant and vegetation growth, could have positive effects on food production in certain regions of the world.

The Political Appeal of Energy Taxes

Energy taxes are appealing to those who want to transfer increasing amounts of revenues and control

over resources from the private to the public sector. Unlike more narrowly based excise taxes, such as luxury or "sin" taxes, which target the activities of particular citizens, everyone consumes energy and must do so to survive. The possibilities for avoiding such taxes are few. While people can, to some degree, reduce their consumption of energy, they cannot simply quit living in heated and lighted homes or do all their traveling by foot. The same is true with respect to production activities. Energy is an essential input into all production processes. While at the margin, the use of energy inputs may be substituted for or otherwise reduced — for some industries more than others — the fundamental necessity of energy as a productive input cannot be changed.

In addition to being difficult to avoid, energy taxes also provide the opportunity to tap into a steadily growing revenue base. An economy that experiences any growth is certain to increase its use of energy inputs as it expands. Therefore, economic growth ensures continuous increases in revenues to the Treasury as a result of energy taxes. The only problem is to keep the taxes from being so oppressive and economically damaging that they result in negative economic growth rates.

Finally, particularly attractive to politicians is the fact that energy taxes are generally hidden from direct public scrutiny. This would be especially true of the

proposed Btu tax. While energy taxes are felt by everyone through higher prices of all goods and services, the portion of any total price that is going toward the payment of the tax is generally undetectable. People pay the tax without being conscious of the fact. This reduces citizen resistance to such taxes and also makes them easier to raise. Consider the excise taxes currently on gasoline. While on average, Americans are paying \$.34 per gallon of gasoline in federal, state, and local taxes, very few purchasers of gasoline are aware of the taxes they are paying. All that is observed at the pump is a single price for the product. Furthermore, since gasoline is, one way or another, an input into all production processes, some portion of these taxes is captured in the prices of all goods and services.

Conclusion

The Btu tax is completely at odds with the stated goals of President Clinton's economic policy proposals — to reduce the deficit, enhance our nation's productive capacity, and promote economic growth. There is a trade-off between the growth of government and economic growth. By proposing the Btu tax, President Clinton has indicated he prefers the former to the latter.

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