

# Earth in the Balance Sheet

## Economists go for the green.

By Paul Krugman

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Earth Day is upon us once again. Like most people who think at all about how much burden their way of life places on Spaceship Earth, I feel a bit guilty. But my conscience is clearer than usual this year--and so are those of 2,500 other economists.

Let me explain. A few months ago an organization called Redefining Progress enlisted five economists--the Nobel laureates Robert Solow and Kenneth Arrow, together with Harvard's Dale Jorgenson, Yale's William Nordhaus, and myself--to circulate an "Economists' Statement on Climate Change," calling for serious measures to limit the emission of greenhouse gases. To be honest, I agreed to be one of the original signatories mainly as a gesture of goodwill, and never expected to hear any more about it; but the statement ended up being signed by, yes, more than 2,500 economists. Whatever else may come of the enterprise, it was an impressive demonstration of a little-known fact: Many economists are also enthusiastic environmentalists.

Partly this is just because of who economists are: Being by definition well-educated and, for the most part, pretty well-off, they have the usual prejudices of their class--and most upper-middle-class Americans are sentimental about the environment, as long as protecting it does not impinge on their lifestyle. (I'm happy to reuse my grocery bags--but don't expect me to walk to the supermarket.) But my unscientific impression is that economists are on average more pro-environment than other people of similar incomes and backgrounds. Why? Because standard economic theory automatically predisposes those who believe in it to favor strong environmental protection.

This is not, of course, the popular image. Everyone knows that economists are people who know the price of everything and the value of nothing, who think that anything that increases gross domestic product is good and anything else is worthless, and who believe that whatever free markets do must be right. (A recent example of how this stereotype gets perpetuated is the article by garden-shop entrepreneur Paul Hawken in the current *Mother Jones*. I'm sorry to say that some of the people at Redefining Progress published an impressively ill-informed diatribe along the same lines in the *Atlantic* back in 1995.)

But the reality is that even the most conventional economic doctrine is a lot more subtle than that. True, economists generally believe that a system of free markets is a pretty efficient way to run an economy, *as long as the prices are right*--as long, in particular, as people pay the true social cost of their actions. Environmental issues, however, more or less by definition involve situations in which the price is wrong--in which the private costs of an activity fail to reflect its true social costs. Let me quote from the textbook (by William Baumol and Alan Blinder) that I assigned when I taught Economics 1 last year: "When a firm pollutes a river, it uses some of society's resources just as surely as when it burns coal. However, if the firm pays for coal but not for the use

of clean water, it is to be expected that management will be economical in its use of coal and wasteful in its use of water." In other words, when it comes to the environment, we do not expect the free market to get it right.

So what should be done? Going all the way back to Paul Samuelson's first edition in 1948, every economics textbook I know of has argued that the government should intervene in the market to discourage activities that damage the environment. The usual recommendation is to do so either by charging fees for the right to engage in such nasty activities--a.k.a. "pollution taxes"--or by auctioning off rights to pollute. Indeed, as the extraordinary response to the climate-change statement reminds us, the idea of pollution taxes is one of those iconic positions, like free trade, that commands the assent of virtually every card-carrying economist. Yet while pollution and related "negative externalities" such as traffic congestion are obvious problems, in practice, efforts to make markets take environmental costs into account are few and far between. So economists who actually believe the things they teach generally support a much more aggressive program of environmental protection than the one we actually have. True, they tend to oppose detailed regulations that tell people exactly how they must reduce pollution, preferring schemes that provide a financial incentive to pollute less but leave the details up to the private sector. But I would be hard pressed to think of a single economist not actually employed by an anti-environmental lobbying operation who believes that the United States should protect the environment less, not more, than it currently does. (The signers of the climate-change statement, incidentally, included 13 economists from the University of Chicago.)

But won't protecting the environment reduce the gross domestic product? Not necessarily--and anyway, so what?

At first sight, it might seem obvious that pollution taxes will reduce GDP. After all, any tax reduces the incentives to work, save, and invest. Thus a tax on exhaust emissions from cars will induce people to drive cleaner cars or avoid driving altogether. But since it will also in effect lower the payoff to earning extra money (since you wouldn't end up driving the second car you could buy with that money anyway), people will not work as hard as they would have without the tax. The result is that taxes on pollution (or anything else) will, other things being equal, tend to reduce overall monetary output in the economy--which is to say, GDP.

But things need not be equal, because there is already a whole lot of taxing and spending going on. Even in the United States, where the government is smaller than in any other advanced country, about a third of GDP passes through its hands. So existing taxes already discourage people from engaging in taxable activities like working or investing.

What this means is that the revenue from any new taxes on pollution could be used to reduce other taxes, such as Social Security contributions or the income tax (but not, of course, the capital-gains tax). While the pollution taxes would discourage some activities that are counted in the GDP, the reduction in other taxes would encourage other such activities. So measured GDP might well fall very little, or even rise.

Does this constitute an independent argument for taxing pollution, quite aside from its environmental payoff? Would we want to have, say, a carbon tax even if we weren't worried about global warming? Well, there has been an excruciatingly technical argument about this, mysteriously known as the "double dividend" debate; the general

consensus seems to be no, and that on balance pollution taxes would be more likely to reduce GDP slightly than to increase it.

□□□□ But so what? "Gross domestic product is not a measure of the nation's economic well-being"--so declares the textbook as soon as it introduces the concept. If getting the price of the environment right means a rise in consumption of nonmarket goods like clean air and leisure time at the expense of marketed consumption, so be it.

Isn't this amazing? Not only do thousands of economists agree on something, but what they agree on is the warm and cuddly idea that we should do more to protect the environment. Can 2,500 economists be wrong? Well, yes--but this time they aren't. The Great Green Tax Shift--a shift away from taxes on employment and income toward taxes on pollution and other negative externalities--has everything going for it. It is supported by good science and good economics, as well as by good intentions.

□□□□ Inevitably, then, it appears at the moment to be a complete political nonstarter. The problem, as with many good policy ideas, is that the Great Green Tax Shift runs up against the three I's.

First, there is Ignorance. Only last year Congress rushed to cut gasoline taxes to offset a temporary price rise. Not many voters stopped to ask where the money was coming from. So what politician will be foolish enough to take the first step in trying to institute new taxes on all-American pollution, even with the assurance that other taxes will be lowered at the same time? (My friends in the administration tell me that the word "taxes" has been banned even from internal discussions about environmental policy.)

□□□□ Then there are Interests. It is hard to think of a way to limit global warming that will not gradually reduce the number of coal-mining jobs. As labor-market adjustment problems go, this is a pretty small one. But the coal miners and the energy companies are actively opposed to green taxes, while the broader public that would benefit from them is not actively in support.

□□□□ Finally, there is Ideology. It used to be that the big problem in formulating a sensible environmental policy came from the left--from people who insisted that since pollution is evil, it is immoral to put a price on it. These days, however, the main problem comes from the right--from conservatives who, unlike most economists, really do think that the free market is always right--to such an extent that they refuse to believe even the most overwhelming scientific evidence if it seems to suggest a justification for government action.

□□□□ So I do not, realistically, expect the Economists' Statement to change the world. But then I didn't expect it to go as far as it has. Certainly those of us who signed it did the right thing; and maybe, just maybe, we did our bit toward saving the planet.

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*Illustrations by Robert Neubecker.*