CLEAN CAPITALIST
LEADERSHIP COUNCIL
Turning Capitalism Into Clean Capitalism

Policy Brief 2: Understanding Clean Tax Cuts (CTCs)

CTC definition: lower marginal tax rates on equity and debt investment returns for clean solutions that measurably reduce or eliminate pollution. (CTCs are a fiscal application of clean free market policy, which seeks to expand freedom and reduce barriers for clean free enterprise. See CCLC Policy Brief 1.)

First proposed in 2016 by Grace Richardson Fund as a policy innovation opportunity. Developed since then by collaborative, transpartisan working groups involving dozens of think tanks and hundreds of scholars and industry experts. (See CTC/CFM development timeline.)

Designed to correct: the economic distortion, damages and barriers (aka negative externalities) created, when privileged polluters get a free ride, dumping costs on non-polluters. Also designed to eliminate other barriers created by bad incentive design, and inherent in negative incentives. CTCs use no sticks, only positive incentives, freedom-based carrots that shrink – *and do not raise* – barriers.

CTCs do not include conventional market-constricting incentives:

- **Tax credit subsidies**: These usually (a) constrict markets to a narrow niche, giving biggest advantage to ultra-high income tax payers; (b) exclude most mom and pop investors; (c) subsidize tax equity trading lawyers and bankers, leaking subsidy away from clean solutions; (d) can promote failing business models, slowing market growth. By contrast, CTCs broaden market participation, expanding opportunities to all investors, large and small. Marginal tax rate cuts can't benefit unprofitable business models. They incent more cost effectively, with less leakage and better bang for the buck.
- **Municipal Bonds**: These also constrict markets. State and local tax exemption does not cross state lines, so each bond mainly draws rich investors from one city, county or state. This makes muni markets small and illiquid compared to private debt markets, and increases borrowing costs by as much as one percentage point (the illiquidity risk premium).

Clean Tax Cuts include new market-expanding incentives:

- Tax-exempt private bonds and loans to finance profitable, scalable clean infrastructure;
- Tax-free business/investor returns for first 5 plants of new clean energy innovation;
- <u>Lower marginal tax rates for business and investor income, rewarding cleaner products</u>.
- See CCLC Policy Briefs 3 - 5

These mechanisms work well together, by separately targeting three key market segments for industrial activity: (1) early stage entrepreneurial innovation, (2) established debt-side capital markets for scalable industrial infrastructure, and (3) equity markets rewarding development of better clean consumer products. Innovation tax cuts can help solve a critical problem: clean energy technologies are intermittent, and not reliably dispatch-able, which slows the pace of adoption. Innovation tax cuts could accelerate the pace of American clean energy innovation, to deliver dispatch-able, profitable, clean energy solutions. At that point, tax exempt debt and clean free market policy will be ideal for accelerating the pace of deployment of emerging solutions ready for commercial-scale, helping to sell new American clean technology innovations and products to the entire world.

Clean Tax Cuts have both conservative and bi-partisan appeal. The raw concept was initially developed by free market conservatives, then fleshed out by transpartisan working groups drawing input from diverse nonpartisan industry experts and from across the political spectrum.

Free market economists see better free market and environmental benefits from CTC. Wayne Winegarden's 2018 Forbes article, "Free-Market Environmentalism," argues that CTC, by lifting, not imposing, tax burdens on the economy, would have a fundamentally better economic impact that a carbon tax. He also notes tech neutral positive incentives would also more effectively reduce GHGs by broadly accelerating both early stage clean energy innovation and then commercial scale deployment of new innovations, rapidly solving technology constraints now holding back global emission reductions.

CTCs are consistent with distortion-reducing tax preferences of free market economists. While free market economists are often skeptical of tax preferences, they do support a few that are justified by reducing economic distortions and expanding GDP. For example, lower capital gains tax rates are justified on the grounds that investment taxes are more distortionary, and depress GDP more than other taxes. Free-market economists also advocate some tax cuts for socially beneficial activities – such as school choice tax credits, tax exempt health savings accounts, or the charitable tax deduction – all tax preferences preferred on the grounds that allowing these tax preferences can help address problems the market does not, and minimize much more harmful and distortionary tax-and-spend big government programs. Like all these examples, CTCs reduce the distortionary harm of investment taxes, of negative externalities and of big government programs, so boosting GDP.

Progressive Democrat industry experts also understand CTC expands markets and popular participation better than conventional subsidies. Jigar Shah's article, "Supporting Clean Infrastructure without Investment Tax Credits," points out that current tax credit subsidies constrict markets to a narrow circle of ultra-rich investors, and excludes millions of mom and pop middle income investors. Jigar argues that CTCs (in the form of private tax exempt clean asset bonds (CABs) – see Policy Brief 3) expands the market to include all investors, and does so far more cost effectively than outmoded tax credits. He estimates CABs could "double or triple" the pace of clean infrastructure deployment.

Clean Tax Cuts' many free market benefits even appeal to climate skeptics. Deroy Murdochs's 2009 National Review article "**Supply-Side Environmentalism**" the first published piece championing an early version of CTC, notably articulates the case for clean tax cuts from the perspective of a free market conservative climate denier. Key elements of his argument:

- Cutting taxes is nearly always a good thing "for any excuse whatsoever." So said movement-defining free market conservative Milton Friedman, because tax rate cuts expand the economy and personal freedom, and often help shrink government.
- Reducing all emissions is a good thing and makes sense, even if you consider carbon harmless. Murdoch's insight here is why GRF has pioneered "Clean Tax Cuts", not "Carbon Tax Cuts." CTC's are not just tech neutral – picking metrics, not winners and losers. They are also pollutant neutral as well. Supply side mechanisms would be best applied to all major negative externalities, broadly, not just carbon, because the economic benefits of doing so are greater, and the political appeal to conservatives is also greater. Zero emission technologies give us an easy way to do so.
- Replacing economically harmful big government tax and spend programs (subsides, regulation, carbon taxes) with more cost effective and economically beneficial tax cuts is a good thing, because low taxes and spending restraint are good for the economy.
- If climate activists welcome tax cuts for reduced air pollution emissions, that's a win for free market conservatives — whether or not you think climate change is a problem. From the climate denier perspective, we have just won additional tax and spending cuts, and forestalled much worse policy proposals, in exchange for nothing. (A "nothing" which of course is a very big breakthrough "something" for those concerned about finding consensus on climate change.)