TAX CUTS FOR THE NEW ECONOMY[1]

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The proposed tax breaks for timber, utility, gas, and oil interests in the bill just vetoed by the President would have taken our economy in the wrong direction by steering more resources toward physical capital and extractive industries. If Congress and the President are to negotiate another tax bill this year, they should work to create a tax code that promotes investment in intellectual capital and human services, while penalizing waste and inefficiency—in other words, a tax code for the economy of the future.

The GOP tax bill recently vetoed by the President included a package of over $71 billion in tax breaks to business over the next decade. The primary beneficiaries were the usual suspects: multinational corporations; utility companies; and gas, oil, and timber interests. These tax breaks, in addition to harming the environment,[2] would have taken our tax code further in the wrong direction. As the twenty-first century approaches and the global economy beckons, Congress should use this opportunity to design a tax code that represents the economy of the future, not the economy of the past.

Unlike what the tax bill's supporters would have us believe, most of these tax breaks for business would not create jobs or strengthen the U.S. economy. They would only keep struggling industries—the ones that are losing jobs in the information age—on life support. *Lawmakers who object to sending welfare dollars to people who are not working should object just as strongly to providing tax protection to industries that are in a natural state of decline.*

One economic trend that has been especially strong in the 1990s is an increased emphasis on human and intellectual capital, as well as an accelerated movement of the U.S. economy toward the production of services. These are the enterprises that we should be promoting as we move into the twenty-first century. However, the proposed tax breaks would have gone against this trend, and many were aimed at resource- or energy-intensive businesses that cause environmental harm. Moreover, most of the breaks would have encouraged investment in physical plant and equipment, rather than information or human capital. Economists such as Nobel laureate Robert Solow have noted for years that investments in human capital and technological improvement are the engines for growth, not investments in physical plant. Yet the GOP leadership sticks to its view that the way to create jobs is to provide boosts to resource-based industries and physical capital. This represents a 1950s mindset, not an understanding of the economy of 2000 and beyond.

What's more, after promising simplicity for years, the Republican tax writers now champion a bill that would add another layer of complexity along with its special-interest giveaways. As Senator John McCain (R-AZ) said, "Republicans promised to change this kind of behavior. But I think it's fairly obvious that hasn't been the case. Now we're going to see this big thick tax code on our desks, and the fine print will reveal another cornucopia for the special interests, and a chamber of horrors for the taxpayers."[3]

DO THE TAX BREAKS HELP ASCENDANT INDUSTRIES?

The recent Friends of the Earth brief on the anti-environment provisions in the tax bill—which included special loss rules for oil and gas companies, expanded depletion allowances, higher timber tax allowances for reforestation expenditures, and the expensing of geological costs for oil and gas, among many others—estimates that those breaks would have cost more than $1 billion over the next five years. The provisions for oil and gas alone would have cost more than $600 million over the next five years, and more than $2.2 billion through the year 2009.

Is this really where we want the tax code to be going? Make no mistake, the tax code is first and foremost a mechanism to fund the functions of government and meet its revenue needs. But we cannot deny that it also sets up an incentive structure by effectively discouraging those things that it taxes more and encouraging those things that it taxes less. By devoting nearly 10 percent of the tax relief to specific industries, many of which inflict environmental harm, lawmakers would encourage these firms to continue their damaging practices. As Anna Aurelio, staff scientist at U.S. Public Interest Research Group, said, "At a time when we should be curbing smog and global warming, these bills are going to give billion of dollars in tax breaks to the companies responsible for these problems."[4]

At the same time, taxes on labor—predominantly the payroll taxes that have risen from a combined rate of 9.6 percent in 1970 to 15.3 percent today—increasingly penalize people for working harder or upgrading their skills. More than *70 percent* of American families now pay more in these taxes than in federal income tax—all the more worrisome since today's economy is driven by labor- and human capital–intensive businesses.

Clearly, the philosophy behind this kind of tax policy is flawed. We should be rewarding firms that are energy efficient and environmentally clean, and *reducing* taxes on human capital, so we get cleaner production and a more skilled workforce. At the same time, we should be *raising* taxes and penalties on those industries that harm the environment, pollute our air and water, and contribute heavily to global warming. Such an "environmental tax shift" would use the power of prices and markets (rather than regulation) to help the environment, and it would help the economy by creating a more level playing field for the industries of tomorrow—and today.

TABLE 1: U.S. EMPLOYMENT IN GROWING INDUSTRIES[5]

Industry	Employment 1996	Employment 2006 (projected)	Change (number)	Change (percent)
Computer and Data Processing Services	1,207,900	2,509,100	+1,301,200	+107.7%
Management and Public Relations	873,000	1,400,000	+527,000	+60.3%
Health and Allied Services	310,300	466,000	+155,700	+50.2%
Nursing and Personal Care Facilities	1,732,200	2,377,000	+644,800	+37.2%
Engineering and Architectural Services	839,100	1,051,700	+212,600	+25.3%
Pharmaceuticals	258,000	319,300	+61,300	+23.5%
Medical and Dental Laboratories	156,700	238,000	+81,300	+21.3%
Public and Private Education	10,691,500	12,480,400	+1,788,900	+16.7%
Total	16,068,700	20,841,500	+4,772,800	+29.7%

What are the "industries of tomorrow" that got short shrift in the GOP tax bill? They are the ones constantly in the news: biotechnology, health and medicine, management and consulting, retail and other services, law, computers and high technology, education—is there any doubt that these are the industries driving today's economy? They consume relatively little natural resources or raw materials; are more energy efficient; and rely on labor, brainpower, technology, and information flow for their value-added. According to the U.S. Department of Labor, they also boast some of the highest rates of job growth. Consider the data in table 1 above. None of these industries—not one—is energy or natural resource intensive. They all rely primarily on brainpower to make their marks.

While the Republican tax bill did contain provisions to help these growing sectors—the largest is the five-year extension of the research and development tax credit for high tech firms—it still committed only about one-fifth of its targeted business tax relief to these industries.

COMPARING THE FIGURES TO INDUSTRIES IN DECLINE

Much of the other 80 percent of the business tax provisions, which amounted to $56 billion in tax cuts, would have gone to industries "distressed" or otherwise in decline. Compare the data in table 1 to that in table 2, below. When we contrast these two lists, two things stand out. First, all of the "new economy" industries will experience significant job gains over the next ten years. Consider this fact: While the U.S. workforce is projected to grow by 14 percent from 1996 to 2006, all of the employment projections for the industries in table 1 *exceed* 14 percent and collectively boast expected employment growth of nearly 30 percent—over twice the national average. Compare this to the data in table 2, which shows that *the industries receiving a significant share of the new tax breaks are all experiencing zero job growth, or negative growth.* Collectively, these sectors were estimated in 1996 to cut employment by 6.1

TABLE 2: U.S. EMPLOYMENT IN DECLINING INDUSTRIES

Industry	Employment 1996	Employment 2006 (projected)	Change (number)	Change (percent)
Logging	80,100	80,700	+600	+0.7%
Machinery Equipment and Supplies	797,000	796,900	-100	-0.1%
General Industrial Machinery	257,200	250,000	-7,200	-2.8%
Electric Services	386,300	370,800	-15,500	-4.0%
Combination Utility Services	163,300	156,200	-7,100	-4.3%
Fuel Dealers	99,700	93,800	-5,900	-5.9%
Gas Production and Distribution	147,000	136,900	-10,100	-7.0%
Petroleum and Petroleum Products	156,800	139,200	-17,600	-11.2%
Oil and Gas Field Services	169,300	146,000	-23,300	-13.8%
Petroleum Refining	100,200	79,500	-20,700	-20.7%
Crude Petroleum, Natural Gas, and Gas Liquids	148,200	101,500	-46,700	-31.5%
Total	2,505,100	2,351,500	-153,600	-6.1%

percent by 2006. We simply should not be throwing tax dollars to them.

The second thing that we notice when we review these statistics is that the new economy firms have a lot more employees, making up 12.2 percent of the total U.S. workforce in 1996 and 13.8 percent of the projected total in 2006. In contrast, the declining sectors employ 1.9 percent of the current U.S. workforce, and that number is predicted to drop to 1.6 percent in the next ten years. Logic would dictate that if we want to create new jobs and provide tax relief to the businesses that can deliver the biggest bang for the buck, we should reduce taxes on the factors of production important to the sectors in table 1: labor, human capital investment, and financial capital. The proposed tax breaks in the GOP tax bill would have gone in exactly the opposite direction by targeting polluting or extractive industries that represent less than 2 percent of U.S. employment—industries in which employment is already declining.

Simply put, if we are going to give narrowly targeted tax breaks to anyone—a questionable notion in the first place—we need to put them where they will be most effective. This is economic common sense.

In our view, as the country struggles to deal with difficult environmental problems—and as cleaner production methods and new ways to create profit from waste keep emerging—the time has come to alter the incentives embodied in our tax code. We should use this opportunity to create a tax system for the future, one that will help the United States stay at the forefront of the global economy. We should be *reducing* taxes on things that we want more of, such as work, human capital, and technological investment. At the same time, we should be *increasing* taxes on things that we want less of, such as waste, energy inefficiency, and environmental degradation. Countries throughout the world are beginning to shift their tax systems in this direction, and the United States shouldn't be left behind.

ENDNOTES

1. The authors of this paper are Hardy Merriman, an intern at Redefining Progress (RP), and Jeff Hamond, a strategic consultant to RP.

2. For more information on the harmful environmental impact of these tax breaks, see the issue brief from Friends of the Earth, *Missing the Green: Congress Proposes Tax Cuts for Destructive Industries While Ignoring Environment*, published August 5, 1999. The paper is available on the World Wide Web at <http://www.foe.org/act/e4e34tax.html>.

3. From "Business Gets Big Breaks in Tax Bills; Surpluses Allow Lobbyists to Win Billions in Relief from Capitol Hill GOP," by Dan Morgan, *Washington Post*, July 24, 1999, page A1.

4. Ibid.

5. Taken from the U.S. Department of Labor's Bureau of Labor Statistics (available on the World Wide Web at <http://stats.bls.gov:80/datahome.htm>).

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