FSR Climate Annual Conference 2022 – 8th edition

Thursday 1 December

10:00-12:15 | Session – Environmental taxation

Presenter: Lucy NAGA (Durham University)

Title: *Kantian Preferences and Dirty Goods within the Ramsey Model of Optimal Taxation*

Abstract:

We build upon the Ramsey optimal commodity taxation structure (Ramsey 1927) to investigate how moral green preferences influence optimal taxation for goods with environmental externalities. When investigating optimal taxation in the presence of green consumerism, economists largely focus on corrective Pigouvian taxation within partial equilibrium models in a first-best world. Depending upon the operationalisation of green preferences, studies find that optimal corrective Pigouvian taxes reduce or stay constant. We employ Roemer's (2010) formalisation of Kantian moral preferences to model how green consumers optimise their consumption of dirty goods; this states that consumers would choose the consumption level at which they would not wish for all agents to deviate from their current consumption level by any common amount. We incorporate these enriched consumer preferences within the Ramsey model in a second-best world, introducing both dirty and clean goods. Our results show that in the absence of Kantian preferences, when consumers optimise in a neo-classical fashion, the Ramsey Rule does not hold. Henceforth, in addition to a revenue-raising Ramsey tax, a corrective Pigouvian tax must be charged on the dirty good. On the other hand, when endowed with Kantian moral preferences, consumers voluntarily internalise environmental externalities, removing the requirement for corrective taxation, and resulting in the Ramsey Rule holding. Furthermore, moral preferences reduce the responsiveness of demand to market forces, increasing the inelasticity of demand for dirty goods, and hence increasing the level of optimal Ramsey taxation which should be charged on dirty goods relative to clean goods.

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