

# **Environmental Policy, Public Finance and the Labour Market In a Second-Best World**

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## **Abstract**

Environmental and tax policies and the optimal provision of clean and dirty public goods are analyzed within the context of a second-best framework of optimal taxation. Households consume both clean and dirty commodities. Degradation of the natural environment occurs due to the consumption of dirty private and public goods, but can be offset when the government engages in abatement activities. Increased environmental concern implies a higher dirt tax, a lower tax on labour, less employment, more public abatement, and a cleaner environment. If the elasticity of substitution between private consumption commodities and leisure is large and that between clean and dirty goods is small, public consumption may expand while private consumption contracts. Otherwise, public consumption falls.