Joint Economic Committee
Republicans
Senator Sam Brownback *Ranking Member*
Representative Kevin Brady *Senior House Republican*

Republican Staff Commentary

Federal Gasoline Tax Targeted For New Revenues

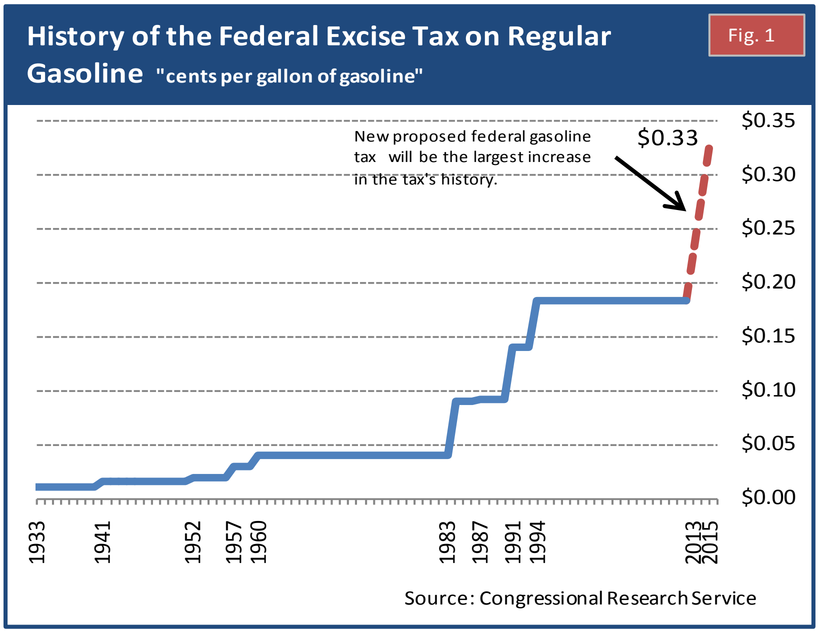
December 16, 2010

Among the revenue raising provisions included in the deficit-reducing proposal of the National Commission on Fiscal Responsibility and Reform is a record 15-cent increase in the federal gasoline tax to be gradually implemented between 2013 and 2015. Currently, the federal gasoline tax rate is 18.4 cents per gallon on regular unleaded gasoline and 24.4 cents per gallon on diesel.[1] The proposed increase would bring the total federal gasoline tax to 33.4 cents per gallon on regular unleaded gasoline and 39.4 cents per gallon on diesel (an increase of 82% in the tax on regular gasoline and 61% on diesel). This would be the largest federal fuel tax increase in U.S. history.

The hidden nature of gasoline taxes and the volatility of gasoline prices make it an easy target among policymakers looking to raise tax revenues. Unlike retail sales taxes that are added on top of posted prices, the gasoline tax is included in the price and retailers are required to post the full price of gasoline, including all taxes. Additionally, because gasoline prices fluctuate significantly on a weekly and even daily basis, gasoline tax increases are easier to hide from consumers who might perceive the price increase as a normal, market-driven fluctuation.

History of the Gasoline Tax

President Herbert Hoover implemented the first federal gasoline tax in 1932 at 1 cent per gallon, intending to balance the budget with the additional tax revenue (Fig.1). Congress last increased the federal gasoline tax by 4.3 cents per gallon in 1993 under President Clinton. The two previous increases in the federal gasoline tax in 1990 and 1993 went directly toward deficit reduction.[2] This new proposal, however, advocates allocating the additional revenue to finance the Highway Trust Fund (HTF), as was done in 1956 under President Eisenhower and in 1982 under President Reagan.



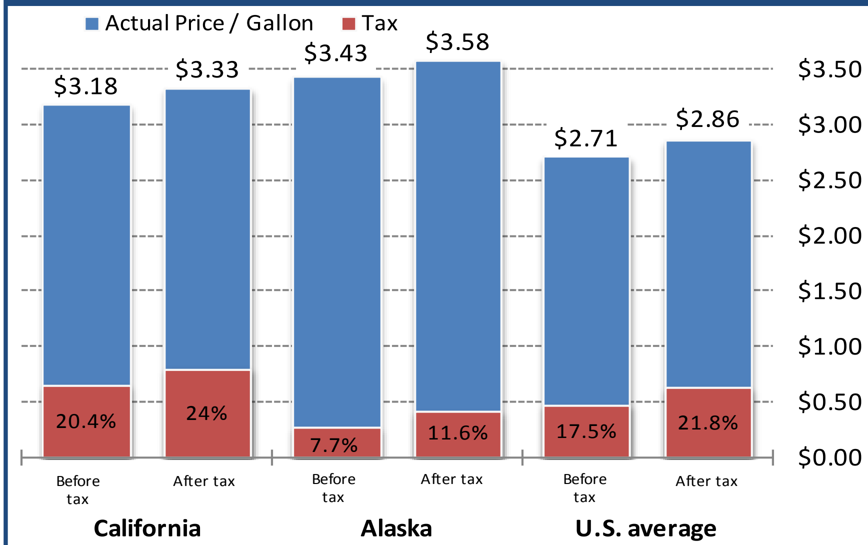
Estimated Revenues from the Proposed Gasoline Tax Increase

According to the proposal, if Americans' driving behavior and fuel consumption remain relatively unchanged, the additional gas tax will generate an estimated $25.6 billion annually in tax revenue, once fully implemented.[3] When estimating the effects of this tax, however, policymakers tend to ignore the indirect economic effects of the tax and possible changes in consumer behavior. Increases in gasoline prices reduce consumption over the long run, which means that actual revenues would fall short of the estimated $25.6 billion. According to a 2008 CBO study, a 10% increase in the price of gasoline can lead to about a 4% decrease in consumption over the long term.[4] Using this relationship and current gasoline prices, a 5.5% increase in the price of regular unleaded gasoline due to the new tax would reduce consumption by about 2.2%.

State Gasoline Tax Rates

Fig. 2

Federal and State Taxes as % of Regular Gasoline Prices (California & Alaska Aug 2010; U.S. average Sep 2010)



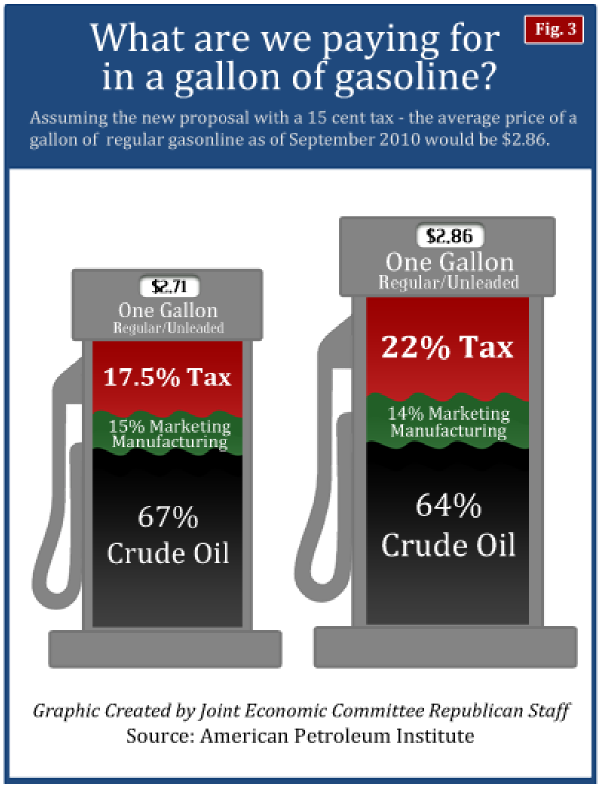
Source: U.S. Energy Information Administrationn, American Petroleum Institute

Consumers are required to pay more than just the federal gasoline tax when they fill up at the pump. Individual states have the authority to- levy additional taxes on gasoline. These taxes - which typically come in the form of excise taxes and sometimes additional sales taxes - can be implemented as cents per gallon, as an ad valorum rate, or both, and the taxes can occur at either the wholesale or retail level. The American Petroleum Institute (API) reports that all 50 states impose differing excise taxes. In addition, 11 states levy sales taxes, which amount to taxes on taxes because they apply to the full cost of a gallon of gasoline, which includes Federal and State excise taxes.[5] According to the U.S. Energy Information Administration (EIA), as of September 2010, total state taxes on regular gasoline averaged 29.0 cents per gallon (California's 46.6 cents tax is the highest and Alaska's 8 cents tax is the lowest).[6] The average total tax burden on a gallon of regular gasoline is 47.4 cents per gallon (California's total of 65 cents is the highest and Alaska's 26.4 cents is the lowest).[7]

The Highway Trust Fund

The proposal calls for new revenues from the 15-cent gasoline tax to be devoted to the Highway Trust Fund (HTF). The HTF was created in the 1950s to fund the construction and repair of interstate highways. Today, about 45% of all highway spending comes from the HTF.[8] Of the 18.4 cents per gallon federal tax, 99.5% (18.3 cents) is earmarked for the HTF.[9] In recent years, the HTF has increasingly fallen short of funds necessary to support transportation outlays, which has prompted bailouts from general revenues of the federal government.[10] In 2008 and 2009, taxpayer bail outs of the HTF amounted to $8 billion and $7 billion, respectively.[11]

Rather than increase the gasoline tax, it has been suggested that repealing the Davis-Bacon Act could free up additional resources and result in a similar improvement in the Highway Trust Fund.[12] The Davis-Bacon Act, enacted under the New Deal, mandates federal projects pay workers the prevailing wage in the region where the work is executed. Because this mandate usually results in inflated wages for federal transportation projects, repealing it would significantly reduce the cost of these projects and improve the solvency of the HTF as well as reduce the burden on federal, state and local government budgets.



Factors Affecting Gasoline Prices

Three main components contribute to the retail price of gasoline: crude oil, manufacturing and marketing, and taxes. The single biggest component of the price of gasoline—accounting for 2/3 the total cost—is crude oil (Fig. 3). If the 15-cent increase in the Commission's report is adopted, the cost of regular gasoline would rise by 5.5% to $2.86 and total taxes paid would rise 32% to almost $0.62 (based on September 2010 prices).

The Economics of the Gasoline Tax

The demand for gasoline is relatively inelastic in the short run (meaning people do not significantly reduce their consumption in response to a price increase), so an increase in the gasoline tax should increase tax revenue. When gasoline prices surged to record levels in 2006 and 2007, studies showed that consumers responded in the short term by saving less. From the fourth quarter of 2006 to the fourth quarter of 2007, the decline in savings alone covered 55.8% of the increase in gasoline spending.[13] In the long run, however, the demand for gasoline is made more elastic by behavioral adjustments in response to price increases such as: reduced driving, use of transportation not affected by gasoline prices, and purchases of more fuel efficient cars.

An increase in the gasoline tax also indirectly increases the price of goods and services. This is because rising gasoline prices contribute to higher transportation costs, which raises expenses at all stages of production. In addition to more costly gas, consumers will face higher prices for basic items like food and clothing. It is estimated that a one cent increase in the price of gasoline costs consumers $4 million each day.[14] Wal-Mart estimated that, in 2007, the increase in gasoline prices tightened the average family budget by $7.00 per week, or $364 per year. [15]

The effect of rising gasoline prices on family budgets was evident in the summer of 2008 as record high gasoline prices have been listed among the probable causes of the financial crisis. A recent report by the Illinois General Assembly's Commission on Government Forecasting and Accountability found that rising gasoline prices were met by a decline in non-gasoline purchases and non-gasoline tax revenues. While the state's gasoline tax structure (a 5% sales tax on gasoline in addition to Illinois' 19-cent per gallon excise tax) meant that revenues increased 2% due to rising gasoline prices, a decline in non-gasoline purchases resulted in a 7.7% drop in non-gasoline revenues. The net result was a loss in revenue for the state. While other factors certainly attributed to the 7.7% decline, the increase in the price of gasoline was a significant factor.[16]

Micro and Macro Effects of the Proposed Tax Increase

JEC staff calculations, based on 2008 data from the Federal Highway Administration and the API, estimate that the 15-cent gasoline tax would cost the average driver an extra $86 per year.[17] In addition to directly paying the 15-cent tax when they fill up their tanks, consumers will also feel the impact of the tax through higher prices on goods and services as a result of increased transportation costs pushing up prices. Raising the gasoline tax is yet another means of taking money away from individuals and putting into the hands of government officials who believe they can spend it more efficiently. All taxes have negative impacts on the economy and a new gasoline tax is not immune from these negative spillover effects.

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[1]Energy Information Administration, "Explanatory Notes: Petroleum Marketing Monthly," November 2010, http://www.eia.doe.gov/pub/oil_gas/petroleum/data_publications/petroleum_marketing_monthly/current/pdf/enote.pdf

[2]The Tax Foundation, "Federal Gasoline Excise Tax Rate, 1932-2008," April 30, 2008, http://www.taxfoundation.org/taxdata/show/1067.html

[3]This calculation assumes that gasoline consumption will remain at 2008 levels in 2016.

[4] CBO Study, The Effects of Gasoline Prices on Driving Behaviors and Vehicle Markets, January 2008, http://www.cbo.gov/ftpdocs/88xx/doc8893/01-14-GasolinePrices.pdf

[5] U.S. Energy Information Administration: Independent Statistics and Analysis, "A Primer on Gasoline Prices," http://www.eia.doe.gov/pub/oil_gas/petroleum/analysis_publications/primer_on_gasoline_prices/html/petbro.html

[6]American Petroleum Institute, "October 2010 Summary Report," October 2010, http://www.api.org/statistics/fueltaxes/upload/October_2010_gasoline_and_diesel_summary_pages.pdf

[7] American Petroleum Institute, "U.S. Pump Price Update," December 1, 2010, http://www.api.org/aboutoilgas/gasoline/upload/PumpPriceUpdate.pdf

[8] Fox News, "Federal Highway Trust Fund Set to Face Shortfall in 2009," May 20,2007, http://www.foxnews.com/story/0,2933,274113,00.html

[9] The remaining 0.5% or 0.1 cent per gallon is allocated to the Leaking Underground Storage Tank Trust Fund (LUST).

[10] Congress' use of HTFs in recent years to pay for projects unrelated to transportation has contributed to the insolvency of the HTF.

[11] The Washington Times, "Federal dollars for federal roads," March 1, 2010, http://www.washingtontimes.com/news/2010/mar/1/federal-dollars-for-federal-roads/

[12] This also has been proposed by Americans for Tax Reform, "Simpson-Bowles Gas Tax Neither Warranted Nor Necessary," November 11, 2001, http://www.atr.org/simpson-bowles-gas-tax-neither-warranted-a5649

[13] Center for American Progress, "Record Gas Prices Add Pressure to Already Squeezed Consumers," April 22, 2008, http://www.americanprogress.org/issues/2008/04/record_gas_prices.html

[14] Christian Science Monitor, "High gas prices likely to affect holiday spending this year," November 5, 2010, http://www.csmonitor.com/Business/Latest-News-Wires/2010/1105/High-gas-prices-likely-to-effect-holiday-spending-this-year

[15] University of Southern California at Marshall, "Gasoline Prices, Consumers, And The Economy," Lars Perner, Ph.D., Assistant Professor of Clinical Marketing, August 11, 2008, http://www.consumerpsychologist.com/gasoline_prices.htm

[16]The Southern, "Higher gas prices don't mean more money for state," November 12, 2010, http://thesouthern.com/news/local/state-and-regional/article_c27d9e82-ee1f-11df-b142-001cc4c03286.html

[17] Federal Highway Administration, " Highway Statistical Report," 2008, http://www.fhwa.dot.gov/policyinformation/statistics/2008/index.cfm, American Petroleum Institute, " State Gasoline Tax Reports", October 2010, http://www.api.org/statistics/fueltaxes/upload/October_2010_gasoline_and_diesel_summary_pages.pdf, These are JEC calculations using estimates from the Federal Highway Administration's Highway Statistical 2008 Report and American Petroleum Institute's State Gasoline Tax Report.