Order Code RL30497

Suspending the Gas Tax: Analysis of S. 2285

April 7, 2000

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ABSTRACT

S. 2285 (Lott) proposes to suspend the motor fuels taxes in order to provide some relief to consumers, truckers and others burdened by the recent spike in petroleum product prices. This report describes the changes S. 2285 would make to the rather complex structure of motor fuels taxation, and discusses some of the major policy and economic issues. This report will be updated as events warrant.

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Summary

S. 2285 proposes to temporarily suspend the federal excise tax on gasoline, diesel, aviation fuel, and certain other motor fuels, which varies by type of fuel and fuel use. The suspension would be for at least 4.3¢/gallon. It would begin on April 16, 2000, and last through December 31, 2000. Thus, on April 16, 2000 the gasoline tax would decline from 18.4¢/gallon to 14.1¢/gallon; the diesel fuel tax would decline from 24.4¢/gallon to 20.1¢/gallon. The bill also provides for a suspension of almost the entire federal tax if two conditions are met: 1) the national average price of unleaded gasoline reaches $2.00/gallon or more at any time during that period; and 2) the projected on-budget surplus in the Treasury is sufficient to offset revenue losses resulting from the tax suspension, which appears to be the case if current projections are borne out. If those two conditions are met all taxes would be suspended except the 0.1¢/gallon Leaking Underground Storage Tank (LUST) trust fund tax, which is also imposed on most transportation fuels. Thus, the 18.4¢ gasoline tax would decline by 18.3¢; the 24.4¢ diesel fuel tax would decline by 24.3¢; and the 4.4¢ tax on commercial jet fuel would decline by 4.3¢ (other fuels taxes, but not all, would decline similarly). In essence, most federal excise taxes on fuels would decline to 0.1¢/gallon. If the surplus is found insufficient, the additional suspension would not proceed.

S. 2285 is intended to help consumers and truckers offset at least part of the recent increases in fuel expenses, which have increased sharply over the last 11/2 years due primarily to sharp increases in crude oil prices. But it is not clear that, under current market conditions, producers would lower their product prices and pass the savings on to consumers. Should market conditions stabilize prior to and during the suspension period, it is estimated that from 2/3 to 3/4 of the tax cut would be passed on as lower prices to consumers.

S. 2285 would reduce motor fuels excise tax collections, but would maintain trust fund revenues for the highway trust fund, and the other two trust funds affected by the proposed tax suspension. Revenues would be maintained by allocating amounts that would otherwise be lost from the suspension from the general fund.

S. 2285 may also raise questions about U.S. energy policy, particularly whether a temporary spike in petroleum prices, which has occurred several times in recent history, warrants federal intervention by altering user fees whose revenues are earmarked for services that benefit those that pay the taxes. This is especially the case in view of 1) prices, in nominal terms, are beginning to decline from their peaks; 2) the present economic expansion which has raised real incomes and wealth across the income spectrum and broadly across sectors, and 3) the fact that adjusted for inflation, and despite significant taxes and regulatory burdens, petroleum product prices are still relatively low. Some may also ask questions about what the best focus or target of federal energy policy should be. Should federal policy address rapid petroleum price increases and high petroleum prices as S. 2285 is attempting to do? Should federal policy address low oil prices as it did when it enacted $500 million in loan guarantees in August of 1999? Or should the federal government attempt to stabilize petroleum prices?

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Introduction

Recent sharp increases in gasoline and diesel fuel prices have sparked congressional interest in proposals to relieve at least part of the financial burden of these price increases, which have increased consumers' and truckers' fuel expenses significantly from the lows reached about 11/2 years ago. The idea is to reduce the federal motor fuels excise taxes – the only instrument the federal government has for affecting petroleum product prices – while prices are high. This approach has been suggested before. In the spring and summer of 1996, after a spurt in crude oil prices of about 50% or $6.00/barrel or from October 1995 to April of 1996 (which caused fuel prices to increase about 20¢/gallon over that time period) there was an unsuccessful effort to repeal the 4.3¢ increase in the excise taxes, that had been imposed by the Omnibus Budget Reconciliation Act of 1993 as a deficit-reduction measure.

The legislative focus currently is on S. 2285, which would temporarily suspend most transportation fuel taxes by at least 4.3¢/gallon (and possibly more depending on what happens to gasoline prices). Some have speculated that this bill might be offered as an amendment to the tax cut legislation measure marked up by the Senate Finance Committee on March 30, 2000 (the Marriage Tax Relief Act of 2000). On March 30, 2000 the Senate approved a cloture motion by a vote of 86 to 11, effectively agreeing to debate the bill when it comes to the floor. On April 6, Senators Byrd and Warner introduced a non-binding amendment to the FY2001 budget resolution (S.Con.Res. 101) expressing the sense of the Senate that the resolution should not assume a reduction in fuels taxes as proposed in S. 2285.[1] The amendment passed, 65-35. While some interpreted the vote as a setback to the prospects for S. 2285, Senator Lott was reported as still intending to bring the legislation to the Senate floor during the week of April 10.[2]

This report describes the changes S.2285 would make to the rather complex structure of motor fuels taxation (table 1) and discusses some of the important policy and economic issues.[3]

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[1] Bureau of National Affairs. *Daily Tax Report.* Wednesday, April 5, 2000, p. G-9.

[2] "Senate Narrowly Backs ANWR Leasing, Rejects Gasoline Tax Rollback," *Oil Daily*, April 7, 2000: p. 2.

[3] For a discussion of other bills see U.S. Library of Congress. Congressional Research Service. *Energy Tax Policy*. Issue Brief IB 10054, by (name redacted). Updated regularly.

Description of S. 2285

S. 2285 proposes to temporarily suspend (for about 8½ months) the federal excise tax on gasoline, diesel fuel and other motor fuels (including kerosene, aviation fuel, and other transportation fuels).[4] General revenue would be used to make up the losses to the various trust funds that receive fuel tax revenue. Tax rates would decline by the following three possible amounts:

- **4.3¢/ gallon.** First, on April 16, 2000, most fuel taxes would be reduced by 4.3¢/gallon. This would last from April 16, 2000 to December 31, 2000 – the suspension period designated under the bill. On January 1, 2001, motor fuels taxes would revert to current law rates in effect on April 15, 2000.

- **All but 0.1¢/gallon.** Second, if at any time from April 16, 2000, to December 31, 2000, gasoline prices – the national average price of unleaded regular – were to reach $2.00/gallon, and 2) projected revenue losses as a result of the suspension are less than the projected federal on-budget surplus for the period, the fuel taxes would be reduced by all but the 0.1¢ Leaking Underground Storage Tank (LUST) trust fund component (as explained below). That is, during the suspension, the federal tax rate on most fuels would be 0.1¢/gallon.

- **Pro-rata tax cuts.** Finally, if on-budget surpluses were insufficient to cover the projected revenue losses from fuels tax reductions, the fuels tax reductions would be pro-rated so the revenue loss would not exceed the available surplus. Presumably the pro-rata amount would be the ratio of the projected surplus for the remainder of the period to the projected reduction in revenues under either of the above two options, but this formula is not specifically established in the text of the bill.[5]

Table 1 (on the following page) shows the tax rates on the various motor fuels by type of fuel and by fuel use. Total tax rates are shown both under current law and under the changes proposed by S. 2285. The last two columns show the tax rates under S. 2285 under two gasoline price scenarios, designated as scenarios A and B:

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[4] Heating oil, including kerosene used as heating oil is exempt from fuels taxation, which generally applies to fuels used in transportation. In the case of kerosene, however, the tax is currently imposed upstream at the refinery level (with some exceptions) and the tax-exempt user has to claim a tax refund or tax credit in order to recover taxes paid. This was done in order to reduce tax evasion. The Congress responded to evidence that some kerosene, which is substitutable as diesel, was being sold as diesel fuel at service stations without the payment of tax. In the future, should dying requirements go into effect, kerosene destined for heating will have to be dyed and no tax will be imposed on such uses.

[5] So if the projected surplus is 50% of the projected revenue loss as a result of the proposed fuels tax reduction, then the reductions would be 50% of those proposed – 50% of either 4.3¢ or 50% of fuels taxes except the LUST fund component, respectively.

Table 1. Current and Proposed Excise Taxes on Fuels Under S. 2285
(¢ per gallon, except as indicated)

Type of Fuel and Use	Excise Tax Rates Under.... Current Law	S. 2285(A)	S.2285(B)
Motor Gasoline			
Cars & trucks on highways (HTF)	18.4	14.1	0.1
Noncommercial boating (ARTF)[1]	18.4	14.1	0.1
Noncommercial aviation (AATF)	19.4	15.1	0.1
Diesel Fuel			
Cars & trucks on highways (HTF)	24.4	20.1	0.1
Intercity buses (HTF)	7.4	3.1	0.1
Inland waterway vessels (IWTF)[2]	24.4	20.1	0.1
Trains (GF)	4.4	0.1	0.1
Jet Fuel (AATF)			
Commercial aviation	4.4	0.1	0.1
Noncommercial aviation	21.9	17.6	0.1
Special Motor Fuels (HTF)			
Liquefied petroleum gas (propane)[3]	13.6	13.6	13.6
Gasohol (with 10% ethanol)	13.0	8.7	0.1
Methanol from oil or natural gas	9.25	9.25	9.25
Compressed natural gas[4]	48.54¢/mcf	48.54¢/mcf	48.54¢/mcf
Liquefied natural gas	11.9	11.9	11.9

Scenario A assumes the national average price of unleaded regular remains below $2.00/gal during the period April 16,2000 to December 31, 2000;
Scenario B assumes the national average price of unleaded regular reaches or surpasses $2.00/gal some time during the period April 16,2000 to December 31, 2000.
[1] 6.8¢ of this tax goes into the general fund (GF).
[2] 4.3¢ of this tax goes into the general fund (GF).
[3] No LUST fund tax is assessed on propane or compressed natural gas.
[4] CNG is the only gaseous motor fuel subject to federal tax, which otherwise only applies to liquid fuels. The tax is on mcf, or thousand of cubic feet, of gas.
Legend: HTF – highway trust fund; ARTF – aquatic resources trust fund; IWTF – inland waterways trust fund; AATF – airport and airways trust fund; GF – general fund.

Source: U.S. Congress, Joint Committee on Taxation. *Schedule of Present Excise Taxes*, March 29, 1999; CRS Report RS20281. *Transportation Fuel Taxes and Legislative Issues.*

scenario A assumes that gasoline prices do not exceed $2.00/gallon during the suspension period; scenario B assumes that prices do exceed $2.00/gallon some time during the suspension period. Tax rates under the pro-rata suspension scenario are not shown since they are contingent on as-yet-unknown factors.

Under current law, fuels taxes vary from 4.4¢ for commercial jet fuel to 24.4¢ for diesel fuel used in cars, trucks, barges or other vessels.[6] In all cases except for diesel fuel used in trains, the revenues from the motor fuels taxes are dedicated for specific trust funds, although some fuels continue to have a general fund component as indicated in the table footnotes. Finally, except for propane and compressed natural gas, all fuels have a 0.1¢/per-gallon LUST component, which generates revenues for the clean-up of spills from leaking underground storage tanks.[7] Thus, gasoline used in cars has an 18.3¢ highway trust fund (HTF) and a 0.1¢ LUST component; similarly, diesel fuel has an HTF component of 24.3¢, and a 0.1¢ LUST fund component. This distinction is important because S.2285 would not suspend all but the LUST fund component under any scenario.

Also, in this regard, there is no longer a separate 4.3¢ component to the motor fuels taxes; this was amended by the Taxpayer Relief Act of 1997 (P.L. 105-34), which, for almost all fuels except those discussed below, combined the 4.3¢ with the pre-existing 14.0¢ HTF tax into a general 18.3¢ gasoline tax, with revenues going into the highway trust fund. In addition, as discussed in the text there is a separate 0.1¢ Leaking Underground Storage Tank (LUST) trust fund tax on virtually all liquid transportation fuels. Only commercial jet fuel and diesel used in trains are now taxed at the basic rate of 4.3¢ introduced in 1993 and the 0.1¢ LUST fund tax. The tax on these fuels also increased by 4.3¢ under the 1993 legislation and subsequent changes were made to the total tax rate on these fuels. But, the 4.3¢ tax remains in current law as a separate component.

Table 1 underscores several other interesting features of S. 2285. First, the bill would not reduce taxes on all fuels. In particular, none of the special motor fuels, except gasohol, would benefit from the suspension in tax rates proposed under S. 2285. Gasohol qualifies for the suspension in tax rates. However, since gasohol benefits from the differential in excise tax rates, the suspension of the gasoline tax would diminish the economic benefits to gasohol as compared with present law.

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[6] Table 1 attempts to simplify somewhat the actual structure of federal excise taxes on motor fuels, which is much more complex that shown in the table. For instance, many fuels are not taxed. In general, nonhighway uses of motor fuels – for example, farm or construction use – is exempt from tax. Others (such as kerosene used for heating oil) are exempt but the exempt user has to claim a tax credit or refund since the tax is imposed upstream.

[7] For information on the leaking underground storage tank clean-up programs see: U.S. Library of Congress. Congressional Research Service. *Leaking Underground Storage Tank Cleanup Issues.* CRS Report 97-471 ENR, by (name redacted). Updated February 17, 1999.

Finally, in some cases – for example, diesel used in trains – S. 2285 reduces revenues that go into the general fund – revenues not earmarked for specific trust funds.

Two important features of S. 2285 are not apparent from the table. First, the bill stipulates that the equivalent amount of revenues from the general fund of the Treasury be allocated to the three trust funds – the Highway Trust Fund (HTF), the Airport and Airway Trust Fund (AATF), and the Inland Waterways Trust Fund (IWTF) – so that there would be no loss in revenues to those funds. The second feature of S. 2285 is a "sense of Congress" provision that motor fuel producers and importers pass the savings from the tax cuts to the consumer, addressing the concern (described in more detail below) that producers will simply maintain or even increase their profit margins rather than passing any reduction on to consumers. As discussed in the next section, the extent to which such a provision would be effective would depend on, inter-alii, economic considerations (the interplay of supply and demand and other market forces).

Policy Issues

S. 2285 raises several economic issues and issues of public policy.[8]

The Burden of Recent Petroleum Product Prices

According to the Department of Energy, crude oil prices more than tripled from the low point in the Fall/Winter of 1998-1999 to the high point reached in mid-March 2000. The average price of gasoline has increased by about 40¢/gallon between February 1999 (the low point) and February 2000. This is about a 40% increase in the average nominal price at the national level. (Increases in certain areas of country, and for other fuels such as heating oil and diesel fuel, have been more pronounced.) With annual gasoline consumption at about 127 billion gallons (1999) the higher price at the pump means that consumers would pay an extra $50 billion for gasoline over one year if these prices remained at those levels.[9] With annual diesel fuel use at about 30 billion gallons (1999), truckers have seen their business expenses increase, and their operating profits decrease, by an estimated $12 billion in one year, assuming they were not able to pass along at least some of their higher costs because of the degree of competition among truckers. Likewise commercial airlines and barge companies have seen their fuel costs increase, although these types of businesses appear to have more flexibility in raising the price they charge for their services. Truckers, particularly the smaller independent motor carriers, have limited flexibility to shift these cost increases;[10] and consumers, of course, have none in the short run.[11]

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[8] For a discussion of the theory and application of energy tax policy see U.S. Library of Congress. Congressional Research Service. *Energy Tax Policy: An Economic Analysis.* CRS Report RL 30406, January 12, 2000, by (name redacted).

[9] Crude prices appear to be declining from their peak reached in mid-March; petroleum product prices lag behind crude prices but are beginning to decline.

[10] CRS estimates that average trucker's fuel costs are about 15% of total operating costs. See (continued...)

But the recent price spike comes after several years of relatively low crude oil prices (and petroleum product prices) culminating in the low prices of the December 1998, when crude oil prices averaged $8.03/barrel (in nominal terms), levels not seen since the 1970s. On average, over the last three years average monthly crude oil prices have averaged about $16/barrel, even with the highs of recent months included. Moreover, if one takes a longer term perspective, fuel prices are still at historically low levels in real terms, despite significant frequent increases in both federal and state excise taxes in recent years. For example, adjusted for inflation, motor gasoline prices are about 40% lower today than they were at their peak in 1981.[12]

The Potential Effect on Petroleum Prices

Would a suspension of the fuel taxes engender an actual reduction in the final price paid by consumers and truckers at the pump (or if not an actual reduction in absolute levels, would prices be lower than without the tax suspension)?

The motor fuels taxes are generally imposed on refiners and terminal operators as the gasoline breaks bulk, i.e., as it is loaded onto the wholesaler's trucks. The refiner or terminal operator assesses the tax on the wholesale purchaser and remits the funds to the Treasury. The wholesale operators, in turn, shift the tax on to retailers who in turn pass it on to consumers. Economic theory and empirical evidence suggest that in the long run, and *under normal market conditions,* much of the tax is shifted forward to the consumer. Because tax increases are shifted forward, and passed through as higher prices, tax reductions are also assumed to be passed through to consumers in the form of reduced product prices.

When market conditions are unstable or volatile, however, e.g., when there are shortages, and therefore strong upward price pressures, demand is by definition strong relative to supply – it is a seller's market – which reduces incentives to actually lower price. Under current market conditions, there is a possibility that much of the benefit of suspension in fuel tax rates might actually accrue to producers (refiners and terminal operators) rather than consumers. It would depend on what happens to the markets, and to prices specifically, before S. 2285 was enacted. If market conditions do not stabilize or even worsen – shortages continue – then little, if any, of the tax cut is likely to be passed forward to consumers. If on the other hand, market conditions return to "normal" – supply shortages ease, and prices decline and stabilize – the tax cuts likely would be reflected in lower prices than without the tax. There are some

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[10] (...continued)
CRS Report RS 20521.

[11] In the long run, consumers can adust to price increases in a variety of ways, as witnessed by the many conservation measures in response to the price shocks and supply cutbacks of the 1970s.

[12] According to the Department of Energy, the real price (1982-1984=100) of motor gasoline was 148.8 in 1981. Using recent gasoline price data and estimating the consumer price index for March, CRS estimates real gasoline prices for March 2000 averaged about 92.8, which implies a 38% reduction in real prices from 1981. See U.S. Department of Energy. Energy Information Administration. *Monthly Energy Review.* February 2000, p. 13; and Bureau Labor Statistics average price data.

indications that this is happening now, which suggests that if S. 2285 were to be enacted after markets return to normal that most of the tax cut (an estimated 2/3 to 3/4 of it) would benefit consumers.

Another factor that might dampen the effect of lower prices is that some states (California and Nevada, and others) have statutes that stipulate that any reduction in the federal rate triggers an automatic increase in the state fuel tax rate by some fraction of the federal rate. Clearly, in these states fuel prices might not decrease. Further, to the extent that the federal rate cut were not passed through, but the countervailing state increase was (again due to the tight supply conditions in the marketplace), the proposed suspension might contribute to further price increases.

Highway Trust Fund Issues

Table 1 shows that almost all fuel taxes are dedicated or earmarked for specific trust funds. Thus a cut in those taxes, absent offsetting measures, reduces receipts for those trust funds, which under current law also reduces the available appropriations to those funds possibly reducing spending on fund programs. Much has been made of the potentially adverse effect on the various trust funds, particularly the HTF, which finances the nation's highway infrastructure (and to a lesser extent, mass transit programs), and the AATF, which finances the construction and maintenance of airports. Under the scenario where taxes are suspended by 4.3¢/gallon for the entire period, i.e., for about 8 ½ months, gross excise tax collections would be reduced by about $5 billion, although the net revenue effect would be somewhat less than that.[13] However, S. 2285 states that in determining the amounts to be allocated to the three trust funds, an amount equal to the reduction in revenues shall be treated as taxes received. S. 2285, therefore, would maintain appropriations into the three trust funds with the equivalent funds coming from general revenues.

In the unlikely event that gasoline prices reach $2.00/gallon, S. 2285 stipulates that there would be no additional suspension in fuels tax rates beyond the 4.3¢ – hence no additional revenue losses to the various trust funds – if there is not sufficient on-budget surplus in the Treasury to offset revenue losses resulting from the tax suspension, which appears to be the case if current projections prove correct.

Another issue is that S. 2285 proposes to cut fuels taxes earmarked for various trust funds, which act as a quasi user fee, a charge for the benefits received by taxpayers from the provision of a public good or quasi-public good financed from the user fee revenues. To the extent that charges approximate individual benefits received, the fuels taxes apply to motorists generally in proportion to their use of the highways and highway infrastructure and these revenues are used to build and maintain that infrastructure, which makes them an economically efficient and equitable

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[13] For businesses excise taxes on fuels purchased for business use are deductible against income taxes as a business expense. Reducing the excise taxes, reduces the amount of deductions and increases taxable income, which increases income paid and collected by the Treasury for the general fund. Thus, net federal revenues would decline by somewhat less because there would be some gain in federal income taxes.

part of the tax code, although they are not perfect in this regard. Many believe that S. 2285 would weaken this link between costs and benefits for users of the highway infrastructure.

The "de-linking" of benefits and costs proposed by S. 2285 is not without precedent. Under the Surface Transportation Act of 1982 (P.L. 97-424), 1.0¢ of the 5¢ increase in fuels taxes was earmarked for mass transit rather than highway infrastructure. Today, 2.86¢/ gallon of the HTF taxes go into the mass transit account. Similarly, the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508) which increased the tax by another 5¢/gallon, earmarked 2.5¢ for the HTF and 2.5¢ for the general fund. Finally, the Omnibus Reconciliation Act of 1993 prescribed that the entire increase in fuel taxes of 4.3¢ would go into the general fund.

Energy Policy Issues

S. 2285 addresses the financial burden on consumers from the recent run-up of fuel prices by, perhaps, the only instrument under the direct control of the federal government: federal excise taxes. When combined with state and local excise taxes and sales taxes, property taxes, federal and state income taxes, and the costs of complying with environmental and other regulations, excise taxes are a significant fraction of the price of final petroleum products, particularly when the prices of these products are low. For example, when gasoline prices dipped to a low point of about $1.00/ gallon in the winter of 1999, total federal and state excise taxes averaged nearly 40% of the fuel price.

However, some question whether the federal government should pursue solutions only when energy prices increase, when prices reach very low levels, or when prices are volatile? There is precedent for this, although some have criticized S. 2285 for its short term energy policy focus, which they believe sends the wrong price signal during a shortage. On August 17, 1999, the President signed P.L.106-51, which provides $500 million in loan guarantees for oil and gas producers to relieve them of the adverse effects of the very low oil prices of 1998-99, which declined to about $8/barrel by December 1999. Commensurately, petroleum product prices also declined. But, these measures raise questions about whether policy should address the temporary, short term energy problems or whether policy ought to focus more on the underlying, long term causes of petroleum price fluctuations: sharp variations in the supply of crude, particularly those induced by OPEC; the long-term reduction in the number of petroleum refineries, total refining capacity, and the recent industry practice of carrying relatively less inventory, when compared with prior industry practice.