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Rising Energy Prices May Not Be a Windfall for All Government Budgets

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Rising prices for gasoline and oil translate into record profits for oil companies; consumers fume over the cost of filling their tanks; and state and local government budgets are said to receive a windfall from higher tax collections. The first two statements are undoubtedly correct. The third is more complicated. For state and local governments, higher gas prices present a complex issue with different, and sometimes unexpected and conflicting, implications. This brief outlines some of the consequences of rising energy prices on government budgets.

The Tax Revenue Impact of Rising Prices

There is no doubt that taxes account for a material share of the price of gasoline and that rising gas prices can drive additional revenue to state treasuries. But this does not apply to all gasoline taxes.

The federal government imposes an excise tax of 18.4 cents for each gallon of gasoline sold. An excise tax is levied on a particular good or group of goods, such as motor fuel, tobacco, telephone calls, and liquor.

In addition to the federal tax, every state also imposes an excise tax, which range from a low of 4 cents in Florida to 31 cents in Washington.[1] Only three states impose an excise tax lower than 10 cents, while 28 states (plus the District of Columbia) tax at 20 cents or more per gallon. There have been some changes in this tax since July 2002, but generally not in a way that favors consumers. Since that time, two states have reduced excise tax rates, while 11 have raised them. The critical feature of excise taxes is that they are imposed on a *per gallon* basis, not on the price of the gallon. So in Texas, for instance, the tax is 20 cents per gallon whether that gallon sells for $1.50 or $3.00. In short, rising gasoline prices do not produce a windfall for governments in receipts from excise taxes.

Many states also impose other gasoline taxes in addition to the excise tax. For example, New York imposes a petroleum business tax of 15.9 cents on each gallon; Florida imposes a sales tax, but this is levied on the volume sold (10.9 cents per gallon), not the price; and Pennsylvania imposes a 19.2 cents per gallon oil company franchise tax. Like the excise taxes, these are levied on volume, not price, and so do not rise as the price of gasoline increases.

There is one major tax source that is price-sensitive to the cost of gasoline — the sales tax — and this is the potential source of any tax revenue windfall. Seven states impose a general sales tax on gasoline purchases: California, Georgia, Hawaii, Indiana, Illinois, Michigan, and New York. In states with general sales taxes on gasoline, gas price increases boost the sales tax amount on these purchases. When the sales tax is considered, at both the state and local government levels, the total amount of taxes imposed on gasoline is dramatically higher than the amounts implied when only excise and petroleum-related taxes are considered. Table 1 illustrates how the various sales and state excise taxes are applied, using typical rates and gasoline price points:

Table 1

	2004	*2006*
Average cost of gallon of gasoline (incl. Federal tax)	$1.215	$2.617
7% sales tax	$0.085	$0.177
Excise tax	$0.200	$0.200
Total price at the pump	$1.50	$3.00

Source: Rockefeller Institute of Government calculations

The American Petroleum Institute has calculated the average state and local tax rate by factoring in the sales tax as of April 26, 2006. Total state and local taxes are shown in Table 2:

Table 2

Total Tax Rate/Gallon	*# of States*
Under 10 cents	1
10 to 19.9 cents	10
20 to 29.9 cents	26
30 to 39.9 cents	11
40 cents and above	3

Source: American Petroleum Institute: http://api-ec.api.org/newsplashpage/index.cfm

Alaska is reported to have the lowest combined rate (eight cents per gallon), while the highest rates per gallon are paid in Connecticut (41.2 cents), California (42.2 cents), and New York (49.5 cents). When the federal excise tax is included, the combined taxes per gallon range from a low of 26.4 cents in Alaska to 67.9 cents in New York.

State governments may also realize additional tax revenue from income taxes they impose on the net income of corporations. But this is not a major revenue source for most states — nationally, only about 3.5 percent of state governments' own-source revenue (their total revenues less the amount they receive from the federal government) comes from corporate net income taxes. And that percentage reflects the taxes paid by all corporations, including those whose net income has been reduced because they have been reluctant to pass on the entire cost of gasoline price increases to consumers in the form of higher retail prices. Of course, oil-producing states have the potential for recording significant increases in tax revenue from corporate income taxes.

Government tax collections may also see negative impacts from rising gasoline prices. The most obvious is from the effect that rising gasoline prices have on driving habits. To the extent that rising prices encourage drivers to reduce consumption, receipts from the excise tax will decline.

Governments Are Consumers Also

Generally lost in the debate about windfall tax collections on gasoline sales is that governments at all levels are prodigious users of petroleum products. Governments use significant amounts of gasoline, diesel fuel, and other petroleum products, either directly or through contract arrangements with private sector businesses. They, too, are feeling the impact of rising prices.

The aggregate spending impact related to rising energy prices can be staggering. New York State, for example, estimates that its direct spending for gasoline, diesel fuel, electricity, and natural gas for vehicle use, heating and cooling of buildings, etc., will be approximately 40 percent higher in 2005-06 than in 2004-05. This one-year increase amounts to nearly $185 million.[2]

Sharply rising prices for oil products ripple throughout government budgets. Illustrations of the impact in two such areas follow:

The most obvious example is the direct use of gasoline or diesel fuel by government vehicles — and perhaps the most visible of such instances is school buses. The National Association for Pupil Transportation estimates that the average school bus travels some 15,000 miles a year, lower in urban communities and higher in suburban and rural areas. There are approximately 470,000 school buses in the nation. Now consider that the average bus gets about 10 miles per gallon.[3]

South Carolina offers a unique example because the state provides school districts with transportation services including buses, fuel, and bus maintenance. In 2004, the state purchased fuel for 95.7 cents per gallon while the price in the current year is estimated at $2.25 per gallon (all prices without taxes). Total fuel spending over the same period increased 131 percent.[4]

The rising price of fuel (whether gasoline or the more commonly used diesel fuel) is stretching school budgets everywhere and requiring many to restrict fuel consumption. Some strategies, such as fine-tuning bus routes to reduce miles driven, reducing idling time, and engine tune-ups, represent pure efficiencies. Other measures reduce student programming and limit the number of field trips and trips for extracurricular activities. Some districts have imposed a separate transportation fee on students' families, and at least one closed school for two days to reduce fuel use.

A less obvious area where government spending is affected by rising oil and gasoline prices is in the broad range of commodities purchased by state and local governments. One such activity that

is affected by rising prices for petroleum products is highway maintenance and construction. For example, most highways and streets are paved with a mix of asphalt, a petroleum derivative, and other products. The price of asphalt has tracked closely to oil and gasoline in recent years. From an average price of $210 per ton in 2003, asphalt has climbed sharply to its current price of $314 per ton in 2006. And it takes approximately 45 tons (along with 700 tons of other materials) to pave each mile of a two-lane highway. Taken by itself, the recent rise in the price of asphalt adds approximately 15 percent to the cost of materials need for each paving job. Rising fuel prices are also embedded in other commodities. Before the current surge in fuel prices, the New York State Department of Transportation was budgeting just over $34 million for the purchase of salt for the current year. Actual costs are now estimated to exceed that earlier budget by nearly 9 percent and the projection for next year is above $40 million, a budget-to-budget increase of more than 17 percent.[5]

Other Factors

Gauging the impact of rising oil and gasoline prices on government budgets is made even more complicated by other factors. Governments that do not levy general sales taxes on gasoline — or that do not receive such revenue from another jurisdiction — may be experiencing only the cost pressures exerted by rising prices and not the additional sales tax revenue from higher gas prices. Even states that impose such sales taxes may see highly focused budget stress. For example, many states have established separate funds to support highway and bridge projects. To the extent that these "dedicated funds" are financed with excise taxes, and not general sales tax revenue, the funds will be squeezed between rising costs and stagnant revenues.

Conclusion

Few will argue the political appeal of providing some relief for hard-pressed consumers in the form of tax reductions on gasoline. The financial pain of rising prices, compounded by higher sales tax charges in some cases, is especially acute for low- and moderate-income drivers. But lobbyists, taxpayers, and the media should recognize that this is a complex issue that needs careful consideration. When all the above factors are considered, the potential government "windfall" is far less than a simple sales tax calculation would suggest and, in fact, may be producing net budget deficits in many jurisdictions. Government policy makers need to view any "windfall" in the context of the entire budget, balancing any additional revenue against higher spending, and even declines in other tax sources.

Endnotes

1 Source: American Petroleum Institute.

2 Louis Raffaele, Expenditure/Debt Unit Chief, New York State Division of the Budget.

3 Michael Martin, Executive Director, National Association for Pupil Transportation.

4 Don Tudor, State Director of Pupil Transportation, South Carolina.

5 New York State Department of Transportation.