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Gasoline Taxes and Rising Fuel Prices

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Although there have been proposals to cut state or federal gas taxes as a response to rising gasoline prices, high taxes are not to blame for current high prices. In the past six months, retail gasoline prices have increased from an average of \$1.78 per gallon to \$2.22 per gallon (as of June 27, 2005), marking an all-time high in nominal gasoline prices and the highest real prices since 1985. However, gasoline taxes have stayed relatively constant throughout the past decade and have even fallen in real terms.

The chart below shows the composition of gas prices from 1968 to 2005 in 2004 dollars. Since 1995 the federal tax has remained at 18.4 cents per gallon (cpg) while the average state gasoline excise tax increased from 22cpg to 25.6 cpg. Factoring in inflation, the real value of total gasoline taxes has fallen from 58 cpg to 43 cpg (in 2004

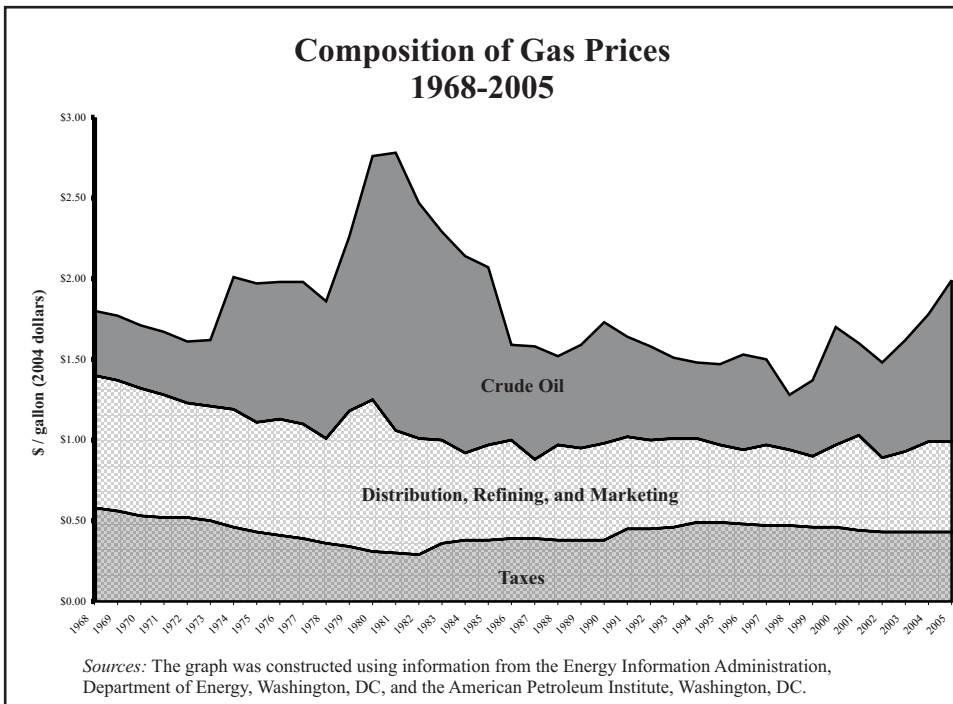
dollars) since 1968. The share of total gasoline prices attributable to taxes has also declined. In 1995 taxes accounted for approximately 33 percent of gas prices; in 2005, taxes accounted for 22 percent. If gasoline taxes had remained constant in real dollars at 1968 levels we estimate that gasoline consumption would be about 7 percent lower than current levels. (This is using a long-run price elasticity from Agras and Chapman, 1999.)

Differences in taxes also explain very little of the gas price differentials between states. State gasoline excise taxes vary from 7.5 cpg in Georgia to 32.9 cpg in Wisconsin. (Eleven states also levy sales and other taxes.) While California has the highest average gas prices in the nation, its gasoline tax rate is 18 cpg, the twelfth-lowest tax. In comparison, Texas, with its low gas prices, charges a tax of 20 cpg. Variation in gasoline prices across states is largely due to changes in supply and demand and differing environmental standards. Gasoline prices are generally highest on the West Coast and in the Northeast and lowest in Gulf Coast states.

The recent impact of high gas prices is exacerbated by changes in the types of vehicles purchased. Light trucks (including SUVs) made up 30 percent of new vehicles purchased in 1990 compared to almost half (49 percent) in 2003. While fuel efficiency has improved over time for individual classes of vehicles, the increase in sales of light trucks (largely due to SUVs) has led to a decline in the overall average fuel economy (sales-weighted) from 22 miles per gallon (mpg) to 20.8 mpg from 1990 through 2005.

References

Agras, J., and D. Chapman. "The Kyoto Protocol, CAFÉ Standards, and Gasoline Taxes," *Contemporary Economic Policy*, 17:3, 1999, 296-308.



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