

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is centered in the narrow neck of the hourglass. The text is centered within the hourglass.

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*TRANSPORTATION FUEL TAXES: IMPACTS OF A  
REPEAL OR MORATORIUM*

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**Abstract.** Steep increases in the prices of gasoline, diesel, and other transportation fuels have prompted some Members of Congress to seek to ease the effects on households and businesses. Interest has focused on possible repeal or suspension of the levying of all or part of the federal excise taxes on those fuels.

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## **CRS Report for Congress**

# **Transportation Fuel Taxes: Impacts of a Repeal or Moratorium**

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### **Summary**

Steep increases in the prices of gasoline, diesel, and other transportation fuels have prompted some Members of Congress to seek to ease the effects on households and businesses. Interest has focused on possible repeal or suspension of the levying of all or part of the federal excise taxes on those fuels. Current market conditions and the small amount of tax relief incorporated in most proposals, however, raise uncertainty as to whether prices to individuals and businesses would fall and whether any price decline would be meaningful to consumers. A reduction in transportation fuel taxes would result in a decrease in spending for transportation trust-fund-supported federal programs, unless Congress designated alternate sources of funding for these programs. As a result of the structure of the federal programs the effects of a fuel tax repeal on federal transportation programs would not necessarily be immediate, but depending on the length/scope of the repeal or suspension, they could be substantial.

### **Increase in Crude Oil and Refined Product Prices**

Due to growing tightness in the supply of crude oil, spot prices of crude oil tripled between mid-February 1999 and mid-March 2000, from about \$10 per barrel to about \$30 per barrel. Perhaps more publicized, the futures price of one grade of crude oil exceeded \$34 in early March. The average acquisition cost of crude oil to U.S. petroleum refiners (which includes some transportation costs) increased 145% over almost the same period, from \$10.50 per barrel in February 1999 to an estimated \$25.78 in February 2000.

Because the cost of crude oil to refiners accounts for a substantial portion of the price of refined petroleum products to users, retail prices of gasoline, diesel fuel, and heating oil have risen. Low product inventories and unanticipated refiner shutdowns have

contributed to price increases.<sup>1</sup> The average U.S. retail price of conventional gasoline increased from about 88½¢ per gallon in mid-February 1999 to \$1.51 in mid-March 2000, or 70%. The average on-highway diesel fuel per-gallon price increased from about 95½¢ in late February 1999 to virtually \$1.50 in mid-March 2000, or 60%. Spot prices of jet fuel rose 150% from an average of 36.3¢ in February 1999 to about 91¢ in early March 2000. And home heating oil prices jumped from a fairly consistent average of 86¢ per gallon in the winter of 1998-99 to as high as \$1.86 in early February 2000, or about 115%.

## Proposals to Offset Effect of Higher Crude Oil Prices

The steep increases in the retail prices of refined petroleum products have prompted many Members of Congress to seek means of countering the consequences of higher crude oil prices and/or actually reducing the retail prices. Among other policy options, interest has focused on possible moratoria on, and repeals of, all or part of the federal excise taxes on several transportation fuels.<sup>2</sup>

Virtually all transportation fuels are taxed under a complicated structure of excise tax rates and exemptions that vary by transportation mode and fuel type. Gasoline used in highway transportation is taxed at a rate of 18.4¢ cents per gallon. This is composed of an 18.3¢ Highway Trust Fund rate, the revenues from which are earmarked for the federal Highway Trust Fund (HTF), and a 0.1¢ rate dedicated to funding the Leaking Underground Storage Tank (LUST) Trust Fund. Diesel fuel used in highway transportation is subject to total federal excise taxes of 24.4¢ per gallon, 24.3¢ of which is earmarked for the HTF and 0.1¢ of which goes to the LUST fund.<sup>3</sup> Jet fuel used in commercial aviation is subject to a total tax of 4.4¢ per gallon, 4.3¢ of which is dedicated to the Airport and Airway Trust Fund and 0.1¢ to the LUST fund. Every state also has excise taxes on fuels used for highway transportation; these differ widely by state.

The taxes on gasoline and diesel fuel include a controversial 4.3¢ increment added in 1993; originally designated to be used for deficit reduction, it was redesignated to the HTF by P.L. 105-34. The 4.3¢ portion of the tax on commercial aviation jet fuel, added in 1995, also was originally designated for deficit reduction, and in 1997 redesignated for the Airport and Airway Fund.<sup>4</sup>

In the current situation, congressional attention first focused upon a possible moratorium on the total diesel fuel excise tax. Higher fuel costs for truckers potentially increase hauling charges, transportation costs, and consumer prices, and decrease trucking

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<sup>1</sup> In *How Much We Pay for Gasoline*, 1998 Annual Review & 1999 January — August 1999, the American Petroleum Institute reported that U.S. refiners' average acquisition cost of crude oil accounted for 30% of the average retail price of gasoline for the period January — August 1999.

<sup>2</sup> For a discussion of other policy options, see U.S. Library of Congress, Congressional Research Service. *Coping With High Oil Prices: A Summary of Options*, CRS Report RL30459.

<sup>3</sup> The difference between gasoline and diesel fuel excise taxes was introduced in 1984 by P.L. 98-369, under which use taxes paid by truckers were reduced in exchange for a 6¢-per-gallon increase in the diesel fuel excise tax.

<sup>4</sup> For more details on federal excise taxes on transportation fuels and dedication of revenues, see *Transportation Fuel Taxes and Legislative Issues*, by Bernard A. Gelb, CRS Report RS20281.

company profits. Fuel costs constitute a significant portion of trucking company operating costs.<sup>5</sup> S. 2090 and H.R. 3711 would reduce the federal diesel fuel excise tax to zero for one year following the date of enactment, reinstate the tax until September 30, 2005, and reduce it from 24.4¢ per gallon to 4.3¢ per gallon after September 30, 2005; the tax would revert to its current level if the Secretary of the Treasury determines that the average refiner acquisition cost of crude oil is equal to or less than it was December 31, 1999. S. 2161 would do the same plus require the Treasury Secretary to transfer amounts from the General Fund to the HTF to cover funds not received as a result of the moratorium and the subsequent reduction in the tax.

Other proposals are broader. H.R. 3749 would reduce the federal excise taxes on gasoline and diesel fuel by 10¢ per gallon for 180 days beginning on the seventh day after enactment; it also promulgates that it is the sense of Congress that the full amount of the reduction in the tax be passed on to consumers. H.R. 3844, H.R. 3849, and H.R. 3982 would permanently repeal, as of the date of enactment, 4.3¢ of the total excise taxes on highway gasoline and diesel fuel and on fuels used in one or more of the following: trains, aviation, and inland waterways.<sup>6</sup> S. 2285, it is reported, would suspend the 4.3¢ with respect to gasoline, diesel fuel, kerosene and aviation fuel from April 15, 2000, through December 31, 2000; general tax revenue would be used to replace HTF shortfall.

The above bills have been referred to the appropriate committees of jurisdiction in the respective chambers. On March 21, 2000, the Ground Transportation Subcommittee of the House Committee on Transportation and Infrastructure held a hearing on the general issue of transportation fuel taxes.

## Impacts on Markets and Prices

As indicated, the measures described are motivated by the steep increases in the retail prices of refined petroleum products, and intended to reverse those increases at least to some extent. *Under “normal” market conditions and assuming a reasonable degree of competition*, the market response to a cut in the excise taxes would be a tendency to reduce user prices by an amount less than the tax cut. The taxed entities — refiners, importers, and terminal operators<sup>7</sup> — would view the cut as a decrease in the cost of doing business and pass forward at least some of the cut in the form of lower prices.

Current market conditions, however, may limit or even prevent a reduction in prices to end-users. The crude oil price rise has resulted largely from a tightness in supply stemming from output reductions by some members of the Organization of Petroleum Exporting Countries (OPEC) at a time when world demand for oil was rising faster than

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<sup>5</sup> CRS estimates fuel costs as roughly 15% of total operating costs, based upon data from trucking company annual reports, the American Trucking Associations, DRI/Standard & Poor’s, and the Energy Information Administration (U.S. Department of Energy).

<sup>6</sup> All the bills mentioned in this paragraph apply to non-jet kerosene as well, although it basically is not a transportation fuel. (Because of its physical and chemical similarity to diesel fuel and the consequent risk of tax evasion, kerosene has been made subject to the same excise taxes as diesel fuel in some circumstances, with provision for refunds for tax-exempt uses.)

<sup>7</sup> Depending upon the particular circumstances, federal transportation fuel excise taxes are levied on and remitted by the refiner, terminal operator, or importer.

anticipated.<sup>8</sup> Thus, world and U.S. inventories have shrunk during the past year, and continue to be low in early Spring 2000.

With respect to gasoline in particular, an increasingly tight supply situation has led to the absolute amount of the retail price increase over the last year exceeding the crude price rise on a per gallon basis.<sup>9</sup> U.S. inventories of gasoline currently are the lowest in decades (according to the Energy Information Administration) — greatly limiting the ability of suppliers to increase their offerings. With the supply price elasticity and demand price elasticity very low, particularly in the short run, it is probable that little, if any, of a tax cut would be passed forward.<sup>10</sup>

Moreover, because 4.3¢ is small in relation to current end user prices for transportation fuels, even a full passthrough of a suspension or repeal would have little effect on end user prices. That amount represents less than 3% of the current retail prices of gasoline and of diesel fuel, and 5% of recent spot market prices for jet fuel.<sup>11</sup>

Proposals to suspend the full amount of the diesel fuel tax (only) could be expected to have larger and more complicated market effects. The amount of tax reduction is considerably larger in absolute terms and in relation to current retail prices; 24.4¢ per gallon equals 16% of current prices. Although temporary, singling out one fuel for tax relief could change the relative price structure among distillate refined products (mainly diesel fuel, jet fuel, and heating oil) and introduce incentives to change the proportions of products derived from each barrel of crude oil, all of which would be affected by the seasonality of demand. Also, it is possible that refiners would apply some of the diesel fuel tax cut to the prices of one or more other refined products. Thus, it is uncertain not only that measures that give excise tax relief will result in reductions in prices to end users, but that any reductions will apply to the product given tax relief.

Those proposals that provide for a moratorium rather than repeal add the dynamic that refiners, by not regarding the tax cut as a long term decrease in costs, will be inclined to leave prices unchanged.

Also, although it is not likely that states would, in the short term, reduce or negate the objectives of federal legislation, there also is a chance that some states may try to compensate for a decrease in funding from the Highway Trust Fund by increasing their transportation fuel excise taxes. A few states, in fact, have provisions that automatically increase their taxes to some extent when the federal tax falls below a certain level.

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<sup>8</sup> For some background, see Home Heating Oil: Price and Supply in the Winter of 1999-2000, by Rob Bamberger and Larry Kumins, CRS Report RL30421.

<sup>9</sup> If passed through completely, the \$20-per-barrel rise in crude oil prices would raise retail gasoline prices by 47.6¢ per gallon, whereas U.S. retail gasoline prices rose 63¢ per gallon. (There are 42 gallons in a U.S. barrel.)

<sup>10</sup> Price elasticity is a measure of the responsiveness of quantities demanded by buyers or supplied by sellers to changes in price. Currently favorable economic conditions for households may have further reduced the previously low demand price elasticity for gasoline.

<sup>11</sup> Some airlines contract for some or all of their fuel in advance so as to assure a certain price. Those that did so in the current market probably were able to obtain a lower average price, but would not benefit from a tax suspension or repeal.

## Highway Program Effects

The Transportation Equity Act for the 21<sup>st</sup> Century as amended (TEA21)(P.L. 105-178 and P.L. 105-206), passed in 1998, provided for a dramatic increase in federal highway, highway safety, and transit programs for the six-year period through FY2003. A standard estimate is that TEA21 provides 40% more funding than the funding legislation that preceded it. The key to this funding increase was the creation of a direct budgetary link between growth in revenues accruing to the HTF and programmatic spending.<sup>12</sup> The 4.3¢ increment of the tax is now a substantial part of the trust fund revenue stream and is the vehicle that makes TEA21's funding increases possible.<sup>13</sup> In absolute terms the addition of the 4.3¢ represented an increase of slightly more than 30% in the level of federal fuel taxation.

A decrease in Highway Trust Fund income as a result of repeal or suspension of the 4.3¢ increment, therefore, would automatically lead to a substantial decrease in program spending unless Congress acted to provide U.S. Treasury general funds as a substitute. According to the Department of Transportation (DOT) the elimination of 4.3¢ of the tax (through repeal or suspension) would reduce income to the HTF by approximately \$7 billion per year. A \$1 billion reduction in income would also occur in the transit account.<sup>14</sup> Changes in income to the HTF could trigger a mechanism designed to protect its solvency, thereby requiring reductions in the amount of funds available for highway projects. A second mechanism created by TEA21 to adjust program spending in response to changes in fund income — “revenue aligned budget authority,” known as RABA — also would come into play and reduce highway project spending.

Because of the manner in which federal transportation programs operate, the effects of these reductions would not become apparent in highway project spending until FY2002. According to DOT, the effect on highway spending of a suspension of 4.3¢ of the tax beginning in July of this year would be a \$20.5 billion decrease in spending during FY2002 - FY2003. Individual states would find their available funding reduced in proportion to their current receipt levels. The effects on transit project spending would be delayed until the expiration of TEA21 in FY2004, by which time the transit account would only be able to support a much smaller program. DOT did not make a separate estimate on the effects of a diesel tax moratorium.

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<sup>12</sup> The HTF consists of two separate accounts — highway and transit — which sometimes are mistakenly referred to as separate trust funds. In practice, the highway account and the transit account are often discussed as though they were separate entities, with the HTF being synonymous with the highway account. Approximately nine-tenths of Highway Trust Fund income is derived from the excise taxes on motor fuels; the remainder comes from sales taxes on tires, trucks, buses, and trailers, and truck usage taxes. The highway account receives an allocation equivalent to 15.44¢ of the tax and the transit account receives the revenue generated by 2.86¢ of the tax.

<sup>13</sup> For a discussion of the history of federal fuel taxes for the HTF see CRS Report RL30304, *The Federal Excise Tax on Gasoline and the Highway Trust Fund: A Short History*, by Louis Alan Talley.

<sup>14</sup> [<http://www.house.gov/transportation/ground/03-21-00/basso.html>]

For a number of reasons, mainly related to the continued growth of the U.S. economy, the dollar value to the trust fund of the addition of 4.3¢ effective FY1998 actually is considerably more than the 30% noted above. Americans have been driving more. Travel, as measured by vehicle miles traveled (VMT) increased by 27.1% in the period 1989 to 1999.<sup>15</sup> Annual growth in the late 1990s was equally impressive, 2.5% in 1998 and 2.0% in 1999. This increase in VMT obviously has led to an increase in fuel use. Fuel use in turn has also been inflated somewhat by ongoing changes in the automotive fleet mix that favor larger less fuel efficient vehicles like sport utility vehicles (SUVs). The results of this trend are reflected in a 4.6% increase in gasoline use and a 3.9% increase in diesel use for the period 1997 through 1999.<sup>16</sup>

Given the increase in taxation and the increase in fuel use, the HTF not surprisingly, has seen dramatic increases in revenue over the last couple of years. In FY1997, prior to the addition of the 4.3 cent tax, fuel taxes provided the trust fund with \$23.9 billion in revenues (interest payments provided an additional \$1.5 billion). In FY1999, this had grown to over \$30 billion.<sup>17</sup>

## Aviation Program Effects

The 4.3¢ transferred to the Airport and Airways Trust Fund effective FY1998 has had an equally dramatic effect on AATF revenues. In FY1997, the AATF accrued \$128 million from fuel taxes, primarily on general aviation activity. By FY1999, this component had risen to slightly over \$1 billion. DOT estimates that a repeal or moratorium of this tax component would cost the AATF approximately \$700 million per year.

Congress recently passed legislation reauthorizing federal aviation programs. The Wendell H. Ford Aviation Investment and Reform Act for the 21<sup>st</sup> Century (AIR21) (H.R. 1000) is awaiting the President's signature. This legislation provides a direct link between AATF revenues and certain categories of aviation spending. Federal aviation programs, unlike highway programs, receive a significant portion of their funding from U.S. Treasury general funds.

Because of the structure of AIR21 and its relationship to the congressional budget, a decrease in trust fund income would likely require that congressional appropriators find additional general fund monies for Federal Aviation Administration operations and maintenance, and research, engineering, and development activities. Alternatively, the appropriators would have to find ways to reduce spending for these activities.

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<sup>15</sup> U.S. Department of Transportation. Federal Highway Administration. Travel Monitoring Division. Traffic Volume Trends — December 1999. January 2000.

<sup>16</sup> Standard and Poor's, Platt's Analysis and Consulting Group. U.S. Energy Outlook, Fall/Winter 1999-2000. p. 41.

<sup>17</sup> All trust fund revenue data are from the Budget of the United States. Various years. The actual amount of income accruing to the trust fund in FY1999 was over \$39 billion. This sum includes funds required to be in the fund as a result of provisions of TEA21 not directly related to fuel use.