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CONSERVATION AT ANY COST: INCREASING EXCISE TAXES ON MOTOR FUELS

The Democrats on the Finance Committee are about to endorse a 4.3 cents per gallon increase in the federal excise taxes on gasoline and diesel fuels, and an extension of the 2.5 cents per gallon portion of the existing gasoline tax that was due to expire in October, 1995. These motor fuels tax hikes would reduce GDP by some \$9 billion in 1994 and \$16 billion by 1998. They would reduce employment by about 80,000 jobs in 1994 and 110,000 jobs in 1998.

The Committee hopes to raise about \$7.6 billion per year from these gasoline and diesel provisions by the late 1990s. The reduced use of motor fuels would offset about 8% of the revenue the tax increases would otherwise generate (an amount that may have been factored into the revenue estimate prepared for the Finance Committee). Not accounted for in the Congressional estimates, however, is the fact that the reduced employment and GDP growth would reduce payroll and income taxes, offsetting roughly 30% of the expected revenue from the motor fuels tax increases. The Committee would be lucky if the net revenues reached \$5.5 billion per year. The GDP would fall by roughly three times the amount

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the tax would take in, making the fuel tax increase an extraordinarily inefficient way to raise revenue. There is no excuse for costing the private sector in excess of \$20 billion in taxes and lost output when an equal amount of deficit reduction could be had by cutting government spending by about \$5.5 billion.

One reason that President Clinton gives for insisting on including some form of energy tax in his deficit reduction package is that it would encourage energy conservation. The conservationist justification for this tax increase invokes the paternalistic view that Americans use motor fuels in a wasteful manner.

Conservation is not simply a matter of not consuming. It concerns the optimum timing of production and consumption of exhaustible resources. At issue, therefore, is whether the private market casts up correct or misleading signals concerning present and future demand, current and future costs of production, and the costs of storage. Although they never state it in this manner, the excise tax advocates are arguing that oil companies are charging too little for their product. This underpricing, so the argument goes, causes too much motor fuels to be consumed. The implication is that government can step in with an excise tax that would help establish the correct, i.e., higher, price.

The tax hike advocates presume that the government can know enough about other people's needs to be able to judge for them what level of consumption is wasteful. The corollary is that the government is more farsighted than market participants and could establish the appropriate consumption rate with higher taxes. This argument is based on what Nobel prize winning economist F.A. Hayek has described as a "pretense of

knowledge." In order to come to these conclusions and implement such policies the government would have to "pretend" that it had information that it could not possibly possess. For example, just to know whether individuals are wasting motor fuels the government has to know the purposes for which individuals in society use the fuels and the relative importance that those individuals place on those purposes — obviously an impossible task.

Beyond this, insurmountable informational problems are encountered in attempting to displace entrepreneurial decision-making with governmental decision-making in allocating resources over time. All motor fuels companies face the challenge of optimally timing production. In other words they must decide upon the correct rate at which resources should be depleted. These decisions depend on many factors, including interest rates, current and future production costs, current and expected future demand, the extent to which future discoveries of crude oil might add to reserves and at what cost, and the extent to which new technologies could bring forth substitutes for motor fuels.

Private entrepreneurs face strong incentives to make accurate estimates with regards to all of these factors. If they are wrong the long-run profitability and survival of their businesses will be threatened. But those conservationists who want increased motor fuels taxes are suggesting that producers systematically err in production decisions. Supposedly, the government can obtain better information than the market provides to entrepreneurs, and it can make better decisions about the allocation of motor fuels over time. This challenges credulity. Those who propose raising the motor fuels taxes should be required to prove that private markets fail to cast up correct cost and price data and that their proposal would result in a better rate of resource utilization.

The conservationist argument for new motor fuels taxes is even more incredible, given the terrible record that the government has in regulating motor fuels markets in the past. In the 1970's the government decided that gasoline was overpriced

and put caps on both gasoline and crude oil prices. The result was severe shortages. The government then imposed rationing schemes that saw motorists in some parts of the country waiting in line for hours to fill up while other areas had surpluses of gasoline.

Higher taxes on motor fuels would cause new problems. First, it would result in additional misallocations in a market that is already distorted by federal and state taxes that average 34 cents per gallon. These taxes drive a wedge between the price paid by consumers and the price received by producers. Consumers pay a higher price than they would in the absence of the tax but sellers receive a lower price. So not only is consumption discouraged but so is production, bringing about a reduction in drilling for new oil. The likely outcome is smaller reserves in the future. Additional excise taxes on motor fuels would exacerbate these distortions.

Furthermore, this higher tax would increase transportation expenses for all businesses and households. This would result in higher production costs throughout the economy, with losses of output, employment, and income. The tax hike advocates need to explain why society should bear these costs in order to realize the reduction in motor fuels usage that they deem to be required.

Free markets do not encourage the overutilization of motor fuels. Since the late 1800's when petroleum products first became the dominant source of energy in this country private enterprise has done well in efficiently rationing its use. Major misallocations of oil and motor fuels have only occurred when the government has made a conscious attempt to alter the outcomes that have occurred as a result of free choices made by consumers and producers. More interference with market prices by imposing higher excise taxes on motor fuels would have similar misallocating effects.

Stephen E. Entin
Resident Scholar

Roy E. Cordato
Senior Economist