Evaluating the Motor Vehicle Fuel Tax Reforms in Bill 20-199

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Testimony Submitted to Committee on Finance & Revenue, Council of the District of Columbia for Hearing: "Motor Vehicle Fuel Tax in the District of Columbia"

June 12, 2013

Mr. Chairman and members of the committee, thank you for the opportunity to testify today. My name is Matt Gardner. I am the Executive Director of the Institute on Taxation and Economic Policy (ITEP), a Washington-DC-based nonprofit research group. ITEP's research focuses on federal and state tax policy with an emphasis on sustainability and fairness in the tax laws.

The District of Columbia, like each of the fifty states, levies an excise tax on sales of gasoline and diesel fuel. But the poor design of the city's tax has resulted in sluggish revenue growth that fails to keep pace with infrastructure needs. As a result, the purchasing power of the city's fuel tax has fallen substantially over time.

My testimony makes four points.

1. The best strategy for making conventional fuel taxes more sustainable is to link the gas tax rate to some measure of inflation. By linking the tax to the wholesale price of gasoline, Bill 20-199 would achieve this goal.

2. The use of a "floor" on fuel tax rates, and capping the allowable annual growth in the per-gallon tax rate, are both sensible strategies for managing the short-term revenue yield of the fuel tax .

3. A "revenue-neutral" reform, such as that contemplated in Bill 20-199, will minimize future erosion in the value of fuel tax revenues, but does nothing to reverse the substantial inflationary losses the tax has experienced in the past.

4. Whatever their form, motor fuel excise taxes tend to be regressive, falling most heavily on low-income families. Lawmakers seeking to increase the fuel tax could mitigate the impact of this change by providing more generous refundable tax credits to low-income families.

A Declining Tax—With a Straightforward Remedy

The District of Columbia levies a motor fuel tax on gasoline and diesel fuel at a rate of 23.5 cents per gallon. The excise tax rate has been increased a number of times in recent decades, most recently in 2009. On its face, the city's tax rate appears to have more than doubled in the past thirty years: in 1980, the excise tax rate was 11 cents per gallon, less than half the current rate. Yet by a more sensible measure—the inflation-adjusted tax rate—the city's gas tax has actually declined over the past thirty years. If, the city's 11-cent excise tax had been adjusted for inflation starting in 1980, its current value would be 32 cents per gallon. Put another way, in inflation-adjusted terms, the city's gas tax has actually been *reduced* by about 9 cents per gallon over the last three decades.

Fuel taxes that don't keep pace with inflation are problematic for a very straightforward reason: the cost of repairing and augmenting our transportation infrastructure does keep pace with inflation. So the purchasing power of a "cents-per-gallon" fuel tax, of the sort used by D.C. and most other states, will be smaller and smaller over the long term unless the by tax rate is repeatedly increased.

About one third of the states have dealt with this problem by tying their fuel tax rates to some measure of cost inflation. This can be done by regularly adjusting the cents-per-gallon tax rate for inflation in consumer prices generally, or for inflation in construction costs, or (as Bill 20-199 would do) transforming the tax into a value-based tax. These are all sensible strategies for preventing future erosion in the purchasing power of fuel taxes.

Managing Revenues From a Wholesale Fuel Tax

Tying the city's fuel tax to wholesale prices will help to ensure that tax collections keep pace, over the long run, with construction costs. But in the short run, fuel taxes that are linked to prices can fluctuate in ways that can increase the volatility of the tax. For these reasons, a number of states with price-based fuel taxes have enacted a floor below which tax rates cannot fall—or a ceiling on the allowable growth rate of the tax—to limit the year-to-year volatility in the tax. Bill 20-199 includes a floor provision, requiring that the average wholesale price used in calculating the tax can't fall below the actual wholesale price as of May 19, 2013. These measures can prevent excessive short-term changes in fuel tax revenues, while preserving the long-term ability of revenues to keep pace with funding needs.

Revenue-Neutral Fuel Tax Reform Won't Offset Past Inflationary Losses

The fuel tax changes proposed in Bill 20-199 have been described as revenue-neutral, meaning that their implementation would leave city tax collections roughly unchanged. Reforming the tax in this way will help to preserve the purchasing power of the gas tax going forward—but would do nothing to offset the substantial inflationary losses experienced by the gas tax in recent decades. Put another way, the tax changes proposed in Bill 20-199 would not meaningfully increase the fuel tax in real terms, and in fact would permanently codify the incremental fuel tax cuts that have been caused by inflation over the past thirty years.

Increasing Fuel Taxes Will Make the D.C. Tax System More Regressive

Taxes on consumption are generally *regressive*, meaning that low-income families generally pay more of their income in these taxes than do better-off taxpayers. This is because families near or below the poverty line spend a much larger share of their income than middle- and upper-income families. The fuel tax, whether based on wholesale prices or calculated as a per-gallon excise tax, is no exception. For this reason, any fuel tax reform that increases revenues will make the city's tax system more regressive overall. One sensible strategy for mitigating the impact of regressive tax hikes on the District's poorest families would be to expand existing low-income tax credits such as the Earned Income Tax Credit, or to enact a separate credit explicitly designed to offset the impact of the gas tax.

Thank you for the opportunity to present this testimony.