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Policy Brief

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State Gasoline Taxes: Built to Fail, But Fixable

Every state levies taxes on gasoline and diesel fuel, usually just called "gas taxes." These taxes are an important source of state revenue—particularly for transportation—but their poor design has resulted in sluggish revenue growth that fails to keep pace with state infrastructure needs. This ITEP Policy Brief explains how state gas taxes work, their importance as a transportation revenue source, the problems confronting gas taxes, and the types of gas tax reforms that are needed to overcome these problems.

How Gas Taxes Work

Most states levy a **fixed-rate** gas tax that collects a specific number of cents in tax on every gallon of gas purchased. In Texas, for example, drivers have been paying exactly twenty cents per gallon in state gas taxes for more than a quarter century. Thirty states have gas taxes designed entirely around this type of fixed-rate structure while the remaining twenty states levy **variable-rate** gas taxes where the rate is periodically adjusted—usually once or twice per year.

Among the twenty states with variable-rate gas taxes, there are more than half a dozen types of formulas used to adjust the gas tax rate. Fifteen of these states base their gas taxes fully or partly on the price of gas—much like the traditional sales taxes that most states levy on things like furniture, toothpaste, and televisions. Six states include a broad measure of inflation, the Consumer Price Index (CPI), in their variable-rate formulas. This approach is akin to the annual adjustments seen in many states' exemptions, deductions, and credits offered under their income taxes. Many states include a mix of factors in their variable-rate formulas. Three states (Maryland, Michigan, and Utah) consider both gas prices and inflation, for example, while Georgia adjusts its gas tax rate based on inflation and the rate of improvement in fuel efficiency for new vehicles registered in the state.

A Vital Transportation Revenue Source

State gas taxes are the single most important source of transportation revenue under the control of state lawmakers. Roughly 30 percent of state own-source highway funding comes from state gas taxes. Many states use gas tax revenues for mass transit projects as well, under the sensible assumption that highway users benefit from the congestion-reducing effects of transit.

But while gas taxes remain a vital transportation revenue source today, their relative contribution to state transportation budgets is declining. Taxes and fees paid by drivers (the most significant of which is the gas tax) now make up a smaller share of total highway funding than at any point since the Interstate Highway System was created in 1957. This shift in transportation finance did not come about because of a conscious change in policy. Instead, it is due to flaws in the design of the gas tax that have left it incapable of handling the challenges outlined below.

Challenges Confronting State Gas Taxes

State gas taxes, as currently designed, are an unsustainable revenue source. This means that over time, the revenue generated by state gas taxes tends to fall increasingly short of meeting state infrastructure needs. The most unsustainable type of gas tax is the fixed-rate tax, where the tax rate remains unchanged year after year. But even variable-rate gas taxes are sometimes unable to generate an adequate amount of revenue over time.

The unsustainability of state gas taxes is a result of two important developments. First, vehicle fuel efficiency has risen by 17.2 percent since 1990, from 18.9 to 22.1 miles per gallon. While improving fuel efficiency is no doubt a positive development overall, it also creates an undeniable problem for the gas tax. As efficiency has improved, drivers are now able to travel further distances on each tank of gas before they have to stop, refuel, and pay anything in gas taxes. Those extra miles being squeezed out of each tank of gas are effectively tax-free, relative to what drivers had been paying previously.

The second challenge confronting state gas taxes is the rising cost of building and maintaining the nation's transportation infrastructure. While fuel efficiency improvements directly reduce the amount of revenue raised by gas taxes, the rising cost of construction puts additional strain on whatever revenue is being raised. Since 1990, transportation construction costs have risen by 62.3 percent, meaning that a construction project that previously cost $500,000 would now cost over $800,000 to complete.

But while the costs of asphalt, concrete, and machinery inevitably grow, most state gas taxes are rarely increased. Twenty-two states have gone more than a decade without raising their gas tax rates and sixteen states have gone two decades or more without an increase. Lawmakers worried about the political ramifications of "raising taxes" too often kick the proverbial can down the crumbling road, even if the "tax increase" under consideration is only an attempt to address the inevitable shortfall created by rising costs and improving fuel efficiency.

Consequences of Inaction

Gas tax decline has been a major factor in the worsening condition of the nation's infrastructure. According to the American Society of Civil Engineers (ASCE), a quarter of America's bridges are structurally deficient or obsolete, one-third of the nation's major roads are in poor or mediocre condition, over 40 percent of all major urban highways are congested, and nearly half of all Americans lack access to bus or rail transit. Because of these deficiencies, the ASCE estimates that Americans lose the monetary equivalent of $101 billion in travel time delays and wasted fuel each year. Business leaders are keenly aware of these problems and often come down on the side of raising state gas taxes to fund a more efficient transportation system. Their conclusion is that the economic costs arising from a deteriorating transportation network outweigh the cost of paying more in gas tax.

When gas taxes are allowed to stagnate, the consequences are not always limited to state transportation systems. Recently, several states have enacted long-term raids on their general funds whereby a certain amount of tax revenue usually reserved for education, human services, and other public priorities is siphoned off to make up for lagging gas tax revenues. Some lawmakers have noted that these types of raids succeed in funding infrastructure improvements only at the expense of other vital services. But far too often, a Band-Aid fix based on shifting general revenues into the transportation budget is seen as an easy way to delay politically difficult, but long-overdue reforms to the gas tax.

A variation on this theme involves raising the gas tax, but pairing that change with major cuts in taxes that fund other public services. The result is the same as a general fund raid: more revenue for infrastructure but less revenue for everything else. And when the tax cuts under consideration primarily benefit the wealthy (as cuts to income taxes often do), this approach has the added downside of shifting some of the state's overall tax load away from affluent individuals and toward lower-income drivers instead.

Recommendations for Reform

Despite the dismal condition of so many state gas taxes, there are a few straightforward reforms that states can use to fix these broken, but vital, revenue sources:

- Rising fuel efficiency and construction costs have significantly reduced the purchasing power of state gas taxes. The first and most obvious step that states should take to offset these declines is to increase their gas tax rates.
- An increase in state gas taxes, however necessary, will be of little help in the long-term unless steps are taken to ensure that the tax can withstand future increases in fuel efficiency and construction costs. Restructuring state gas tax rates so that they grow over time can help alleviate this problem. Restructuring can come in a variety of forms, including linking state gas tax rates to construction cost inflation, the general inflation rate, and/or vehicle fuel efficiency.
- Like most taxes on consumption, state gas taxes are inevitably regressive—impacting low-income families far more heavily than any other group. The impact of gas taxes on families struggling to make ends meet is often cited by gas tax opponents, but lawmakers can provide meaningful relief to these families via low-income tax credits, without having to starve states' transportation revenue streams. Lawmakers should take care, however, to structure any offsetting tax cuts in a targeted way. Pairing a gas tax increase with major cuts in other taxes runs the risk of negatively impacting education or other vital services.

Recent Progress

These recommendations are thoroughly tested and growing in popularity. Lawmakers in nineteen states with diverse political climates have increased and/or reformed their gas taxes since 2013. Major infrastructure projects have been able to move forward because of these reforms. And now that most of the country's population lives in states with variable-rate gas taxes that tend to grow over time, funding for vital projects is likely to be somewhat more sustainable in the years ahead.