CARNEGIE ENDOWMENT
FOR INTERNATIONAL PEACE

ROAD *to* RECOVERY

Transforming America's Transportation

Q: WHAT IS YOUR DEFINITION OF TRANSPORTATION SOLVENCY?

U.S. transportation will once again be solvent when the federal surface transportation program requires no General Fund transfers to underwrite the full costs of the program, including deferred maintenance.

Q: WHY RESTORE TRANSPORTATION SOLVENCY INSTEAD OF CUTTING TRANSPORTATION PROGRAMS TO MATCH REVENUES FROM EXISTING FEES AND TAXES?

Infrastructure has long lifetimes that require ongoing investments in maintenance and operation. Present transportation taxes are insufficient to keep what we have already constructed in a state of good repair. Moreover, as the U.S. economy and population continue to grow, America needs additional infrastructure to keep our economic system moving and productive. Cutting sound infrastructure investments to match a shrinking revenue base might save money in the short term, but it will do so at a huge long-term cost to our national economy and overall well-being.

Q: WHAT IS YOUR PLAN TO RESTORE TRANSPORTATION SOLVENCY?

Transportation solvency requires three actions: (1) cut federal transportation assistance programs that have achieved their original purpose, are obsolete, or do not merit continued investment because their costs are greater than their national benefits; (2) invest in projects that grow the U.S. economy and advance congressionally established national performance goals; and (3) fund the full costs of the program through taxes and fees paid by program beneficiaries.

Q: WHAT NEW TAXES OR FEES ARE YOU PROPOSING IN THIS REPORT?

We propose a countercyclical oil and gas pricing structure where an *ad valorem* oil security fee is applied to all oil and refined oil products produced or imported in the United States, and the federal gas tax then rises or falls in an inverse relationship to the rise and fall of world oil prices. In other words, when world oil prices are high, gas taxes are low and an oil security fees is applied. When oil prices are low, gas tax levels are readjusted.

Q: HOW DOES THIS WORK IN PRACTICE?

We propose that an initial 5 percent *ad valorem* oil security fee be applied to every barrel of oil produced or imported based on the average estimated (EIA) cost of U.S. crude oil contracts at the time of enactment (calculated monthly).[1] We call this the "trigger price." If the EIA average U.S. crude oil contract price (adjusted monthly) rises above the trigger price, the federal gas tax would be gradually abated but the cost in lost revenues would be made up, at least in part, by higher *ad valorem* revenues.[2] Likewise, as the world oil price declines below the trigger price, *ad valorem* revenues would decline but the gas tax would be increased to make up for the lost oil security revenue. The trigger price, the oil security charge, and the rate of increase or decrease in the gas tax could all be calibrated to generate the revenues needed to attain transportation solvency.

Q: WHAT ARE THE BENEFITS OF THIS PLAN OVER A STRAIGHT INCREASE IN THE GAS TAX OR A STRAIGHT OIL *AD VALOREM* FEE, OR BOTH?

A straight gas tax (or gas sales tax), if imposed as oil prices are rising, just pushes the price at the pump even higher and hurts consumers and the economy. This plan moves the revenue generation burden toward oil producers when their profits are high. It also ensures that gas taxes are applied only when oil prices are declining and at a rate where the total price of gasoline, including the gas tax, is also declining. Likewise, when oil prices are declining, *ad valorem* revenues decline, and increasing gas taxes can make up for this lost revenue.

Q: IS THIS FAIR?

When oil prices are rising, oil companies are making higher profits and can afford to pay the higher *ad valorem* tax while consumers, who are already suffering from higher gasoline prices, get some relief at the pump. When oil prices are declining, the consumer is receiving the benefit of lower prices at the pump and the gas tax is less of a burden. This proposal brings some stability to volatile gasoline markets, creating a more equitable and stable situation for consumers and businesses.

Q: HOW IS THIS PLAN ADMINISTERED?

All oil produced in or imported into the United States is already subject to an 8-cent per barrel "pollution fee" under the Oil Pollution Act of 1990.[3] This fee is administered by the Coast Guard and collected by the U.S. Treasury. The oil security fee proposed here can use the same administrative structure to collect the *ad valorem* fee simultaneously and with very little added administrative cost. Also, to make sure the *ad valorem* fee or gas tax does not change based on a U.S. estimated crude oil contract price that is calculated by EIA on a weekly basis, we propose that adjustments, up or down, be based on the three-month rolling average in the EIA estimated contract price. That eliminates rapid increases or decreases in either the *ad valorem* fee or the gas tax.

[1] For ease of administration, we propose that the *ad valorem* fee be computed based on the average whole dollar price of oil contracts computed on a monthly basis. For example, a monthly average contract price of $94.49 would be adjusted to $94. Likewise, an average monthly contract price of $94.51 would be adjusted to $95.00

[2] For ease of collection, we propose that the gas tax be adjusted up or down based on changes in the whole dollar average contract price of oil at $3 increments from the trigger price.

[3] P.L 101-380; 23 U.S.C. Section 2701.

Q: OTHER THAN EFFICIENCY AND FAIRNESS, ARE THERE OTHER BENEFITS TO THIS PLAN?

Yes, price stabilization. Imposing an *ad valorem* fee as oil prices are rising discourages speculators from pushing oil prices even higher on the margin. Increasing the gas tax when oil prices are declining prevents the price of gasoline from decreasing and dissuading fuel efficiency on the margin. By imposing the oil fee on the way up and the gas tax on the way down, public policy can help guide gasoline prices to stay within a range. By imposing the *ad valorem* fee upstream of the refinery, it encourages oil companies to adopt downstream process efficiencies to reduce their total fee burden.

Q: WON'T THE OIL COMPANIES JUST PASS ON THE COST OF THE *AD VALOREM* FEE TO THE CONSUMER AND THUS TURN THIS WHOLE PLAN INTO JUST ANOTHER GAS TAX INCREASE?

There are economic studies indicating that increases in the federal gas tax, or oil fees imposed at or above the refinery level, may not be passed on to downstream purchasers, including refineries, distributors, or retail gasoline stations as well as the ultimate consumers.[4] Also, to the extent the fee is pushed downstream as an increase in the cost of gasoline to retailers, Congress can prohibit such a practice.[5] This prohibition could be included in the tax legislation enacting this plan.

Q: WHAT IS DIFFERENT ABOUT THIS FUNDING PROPOSAL THAT MAKES IT FEASIBLE IN AN ANTI-TAX POLITICAL ENVIRONMENT?

First, it is fair, since it spreads the cost of transportation solvency among the oil companies (who depend on the transportation system to supply a market for over 70 percent of their oil products) and retail consumers (who benefit from use of the transportation system). Second, the oil security fee is not a broad-based tax. It is paid by oil companies and thus does not, by its terms, violate any pledge not to impose a broad-based tax on consumers. Third, and most importantly, it is in the national interest to discourage spikes and crashes in gasoline prices that raise havoc with household budgets, businesses, and the national economy, while also solving our transportation debt problem. If the benefits of this plan are honestly communicated to the American people, along with the cost of doing nothing, we believe that the public will support the plan.

Q: WHAT DO MEMBERS OF CONGRESS THINK ABOUT THIS REPORT?

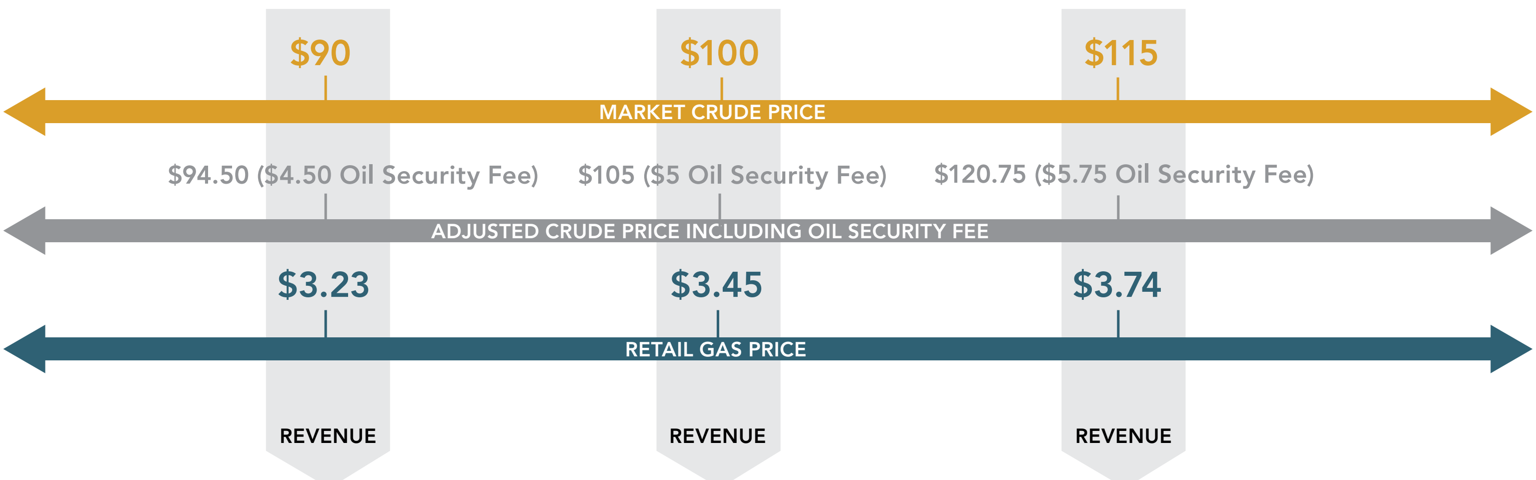
The report and its funding proposal has been presented to various members and staff of House and Senate Appropriations, Budget, and Finance Committees. The problem of transportation solvency has been acknowledged. Members have varying priorities on solving transportation solvency. As expected, Republicans are more inclined to support the report's efficiency recommendations (the program cuts) but not the revenue proposal, while Democrats tend toward the reverse. It is hoped that this report will help bridge this divide and allow a compromise "cut, invest, and fund" solution.

[4] "An increase in the federal tax by 1¢ raises the retail price by 0.47¢ and decreases the wholesale price by 0.56¢. Thus, consumers and wholesalers each pay roughly half of the federal specific tax." See: Hayley Chouinard and Jeffrey Perloff, "Incidence of federal and state gasoline taxes," Economics Letters 83 (2004), 55–60

[5] See Economic Stabilization Act of 1970 (President Richard Nixon invokes this act to limit oil price increases to 2–3 percent annually) as well as the Emergency Petroleum Allocation Act of 1973, which allowed the Cost of Living Council to impose limits on oil pricing.

Q: HOW WOULD THE TAXES AND FEES HAVE LOOKED IN 2011?

WEEK OF FEBRUARY 7	TRIGGER PRICE WEEK OF FEBRUARY 28	WEEK OF APRIL 11
GAS PRICE: $3.13 GAS TAX CHANGE: +10¢	GAS PRICE: $3.45 (approx.)	GAS PRICE: $3.79 GAS TAX CHANGE: -5¢



Week of February 7	Trigger Price Week of February 28	Week of April 11
Oil Security Fee: $25.76 billion	Oil Security Fee: $28.63 billion	Oil Security Fee: $32.92 billion
Gas Tax: $39.76 billion	Gas Tax: $25.76 billion	Gas Tax: $18.76 billion
Diesel Tax: $13.76 billion	Diesel Tax: $9.76 billion	Diesel Tax: $7.76 billion
Total: $79.28 billion	Total: $64.15 billion	Total: $59.44 billion

NOTE: Gasoline prices tend to track crude price movements in a delayed manner, and thus may still rise even after crude prices begin falling. U.S. crude price reflects “crude oil estimated U.S. spot contract price” as reported in EIA’s “This Week in Petroleum.” Gas price reflects “average US retail gasoline price” as reported in EIA’s “This Week in Petroleum.” Adjusted crude price reflects the addition of the 5% per-barrel fee. Adjusted gas price reflects the addition/removal of gas tax in accordance with LITS mechanism.

ASSUMPTIONS: For illustrative simplicity, it is assumed that 100% of per barrel fee is absorbed upstream and 100% of gas tax adjustments are absorbed downstream by the consumer. Thus, retail gas price reflects no change from oil security fee.