

Gas Prices: Policy Gimmicks Are No Solution

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KEY TAKEAWAYS

Rather than fix the root problems that caused gas prices to skyrocket, some lawmakers are proposing policy gimmicks like a federal gas tax “holiday.”

These tired approaches won’t work and would in fact have a counterproductive impact on America’s economy, including driving up inflation beyond its record highs.

It’s time for the government to stop picking winners and losers in the energy market and instead open up America’s abundant domestic energy production.

Americans today are paying record prices for gasoline. The average domestic price for regular gasoline rose from \$2.39 per gallon in January 2021 to \$3.48 per gallon during the week before Russia’s second invasion of Ukraine on February 24, 2022, an increase of 37 percent.¹ The price of gasoline then surged beyond the previous 2008 record-high prices with the most recent national average of \$4.23 per gallon. Particularly on the West Coast, Americans are paying well above \$5 per gallon of gasoline.

Coming at a time of severe inflation throughout this economy,² the additional spike in the price of gas is straining the finances of working families across the country. In a survey by the American Automobile Association conducted in February, 59 percent of respondents stated that they would have to adjust

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their habits or lifestyle if gas prices exceeded \$4 per gallon, a threshold that was reached in early March.³

However, neither liberals in Congress nor the Biden Administration are proposing production-oriented reforms that would lower the price of gas in both the near- and long-term windows. Such reforms would avoid harmful economic side effects, enhance America's energy independence, and combat the inflation that is eroding the value of hard-earned paychecks.

Instead, congressional liberals have responded to the situation with a variety of policy proposals that range from actively counterproductive new taxes to inflationary measures such as government "rebate" payments to individuals and an ineffective temporary "holiday" for the federal gas tax.

Policy Gimmick #1: Gas Tax "Holiday"

The federal government imposes a tax of 18.4 cents per gallon on gasoline. Revenue from the gas tax is placed in the federal Highway Trust Fund (HTF), which pays for a variety of transportation infrastructure activities. This is theoretically justified as a way to charge drivers for the associated costs of the highway system they use. However, federal infrastructure policy has gone far astray from the "user pays, user benefits" model due to non-highway spending diversions and the increasing number of electric and hybrid vehicles.⁴

Some lawmakers are proposing a "holiday" for the federal gas tax (removing it temporarily) as a way to lower gas prices.⁵ As currently discussed, this proposal would not affect the federal 24.4 cents per gallon tax on diesel fuel.⁶ Since the tax holiday proposal would not reduce spending, the proposal would require transfers from the Treasury's General Fund to the HTF in an amount equivalent to the forgone gas tax revenue, adding to the deficit and further damaging the nation's already unsustainable fiscal position.⁷

While Congress should make permanently lowering the federal gas tax a priority, this should be done in the context of broader reforms to the HTF that eliminate wasteful spending and reduce the federal government's highly inefficient infrastructure role.⁸ Further de-coupling HTF spending from taxes would make reform more difficult.

In addition, the federal gas tax currently accounts for only 3–5 percent of the total price of gas for U.S. consumers. Market fundamentals related to supply and demand are the driving force behind the dramatic price surge. Temporarily removing the federal gas tax would do nothing to address these fundamentals, and the effect on prices would be partially blunted by a resulting increase in demand relative to the status quo.

Not only would the tax holiday proposal fail to meaningfully reduce the price of gas, but at least one proposal would give the Internal Revenue Service (IRS) troubling new powers to regulate prices in the economy. S. 3609, introduced by Senator Mark Kelly (D–AZ), states that the Treasury Secretary “may use all applicable authorities to ensure that the benefit of the reduction in taxes resulting from the application of [the tax holiday] is received by consumers.”⁹

Since the language is vague (but expansive), it is unclear what powers, exactly, this would give the IRS. However, it is difficult to see how the IRS could ensure that “consumers immediately receive the benefit of the reduction in taxes” without giving the IRS power to pressure companies into lowering prices that the agency perceives are too high. Clearly, this is well outside the reasonable scope of activities of a revenue-collecting agency. The IRS (and every other government agency) lacks the expertise to determine appropriate prices in the economy. Efforts at government price controls fail wherever they are tried.¹⁰

Policy Gimmick #2: “Windfall Profit” Tax

Representative Ro Khanna (D–CA) recently introduced H.R. 7061, the “Big Oil Windfall Profits Tax.”¹¹ Worse than merely a gimmick, this bill could devastate the oil and gas industry in the United States as well as the broader economy. Despite the name, the tax would not fall on oil companies’ profits at all. Instead, under the legislation, the IRS would collect a per-barrel excise tax on crude oil sales and imports. The amount of the excise tax would be variable and unpredictable and would increase dramatically when oil companies and consumers could least afford it.

The IRS would collect the tax quarterly. The per-barrel tax would be equal to 50 percent multiplied by the difference between the quarterly average Brent crude oil prices over the 2015–2019 average price.¹² For example, in March 2022, the U.S. average Brent crude oil price is more than \$50 per barrel higher than during the 2015–2019 period.¹³ Based on current prices, the bill’s 50 percent excise tax would translate to greater than a \$25 per barrel tax applied to all U.S. oil sales and imports.¹⁴

Policymakers cannot reasonably expect oil companies to absorb such a tax without passing along most, if not all, of the new tax to consumers. A barrel of crude oil yields almost 45 gallons of gasoline and other petroleum products.¹⁵ Therefore, a \$25 per barrel excise tax equates to about 56 cents per gallon of gasoline in higher costs if passed along to the consumer. The impacts would not be limited to gasoline and diesel only. The price of

nearly all goods in the economy would be affected by the increased cost to transport goods, not to mention the thousands of other petroleum-based products that would be directly impacted by the tax.¹⁶

Since the tax would rise dramatically as world oil prices rise (by 50 cents for each dollar of price increase), the tax would amplify any spikes in oil prices after an oil shock. Oil and gas prices in the United States would become far more volatile as a result.

The uncertainty of the tax would make matters much worse. As dangerous as this vicious cycle sounds, it is made even worse by the uncertainty the tax would cause. Oil companies would not know the amount of the per-barrel excise tax until after the end of the quarter, when the quarterly average Brent crude oil price is calculated.¹⁷ Companies would be reluctant to produce and sell oil in the United States out of fear that any oil shock occurring in the same quarter could set off a chain of explosive oil price increases and retroactive excise tax hikes. Perversely, that reluctance to sell oil in the United States could itself act as a supply shock that sets off a chain of runaway price increases.

The Treasury Department would place tax revenues generated from the tax into the inaptly named “Protect Consumers from Gas Price Hikes Fund.” The Treasury Department would make refundable tax credit payments out of this fund to Americans earning less than \$75,000 per year (\$150,000 for joint returns). Payments would be divided evenly between individuals below the income threshold—and in no way connected to how much they spent on petroleum products.¹⁸ The bill includes no work requirements or minimum income requirements as a precondition of receiving payment.¹⁹

Nothing in this bill protects consumers from the gas price hikes the legislation would cause. Quite the opposite is true. In addition to the massive tax hikes that oil companies would pass on to consumers, the bill would incentivize companies to raise prices. Since the “windfall profit” tax is based on economy-wide prices and not the price of oil charged by an individual company, any company charging a *lower* oil price would face a *higher* tax as a percentage of its revenues.²⁰

Policy Gimmick #3: Government Cutting Checks

Congress is in the midst of a spending spree of historic proportions, as just four recently enacted laws stand to add \$5.5 trillion to the national debt.²¹ Although legislators used the COVID-19 pandemic as an opportunity to enact waves of special interest handouts, less than 12 percent of the spending was targeted toward public health.²² The combination of massive

deficit spending and unprecedented Federal Reserve purchases of federal debt²³ are a significant contributor to America's inflation woes.²⁴

One of the signature federal COVID-19 economic policies was issuing stimulus checks to individuals with a combined value of up to \$3,400. H.R. 7143, introduced by Representative Mike Thompson (D-CA) takes a similar approach to the spike in gas prices.²⁵ Under this bill, the federal government would provide checks of \$100 per month per person per household, with a phaseout starting at \$75,000 of income for single earners and \$150,000 of income for dual earners.²⁶ Checks would be sent for any month in calendar year 2022 where the nationwide average price for gas was above \$4 per gallon.

Since there is no associated revenue source or spending reduction in the bill, these checks would be funded through deficit spending. The effect of pouring tens of billions of dollars per month into the economy would be to add even more fuel to the inflationary fire while also worsening America's perilous financial condition.²⁷ These checks would do nothing to address supply-side issues and thus would perversely *increase* the price of gas and other goods and services by fueling more demand.

A similar idea, sending prepaid cards for purchasing gas, was pitched by the Biden Administration but rejected by House Democrats.²⁸ While this might seem to be more targeted at high gas prices, it would cause a correspondingly targeted increase in gas price inflation due to specifically subsidizing gas purchases.

Blindly throwing money at economic problems is a proven policy failure, and directly or indirectly subsidizing gasoline would only serve to repeat the mistake.²⁹

Biden's Green Fantasy

Despite recent rhetoric demanding that oil companies increase oil production, the Biden Administration has actively discouraged investment in new production infrastructure and continued to restrict both supply and demand for oil with expansive regulations on long-term investment, exploration, production, pipeline construction and operation, and consumption of oil.³⁰ This policy agenda is in direct conflict with increasing oil production in the United States.

Regardless of the Biden Administration's aspirations to increase renewable energy use, the U.S. Energy Information Administration (EIA) projects no scenario in which global demand for oil does not increase through at least 2050.³¹ U.S. crude oil production has more than doubled

since 2008 and, along with longtime allies and trading partners such as Canada, has abundant oil resources.³² That production has greatly benefited Americans.

As oil is a globally traded commodity, the United States cannot completely insulate itself from changes in global supply and demand. However, increasing supply does moderate prices and contribute downward pressure, as has been clearly seen in both the current situation and in the recent past. As noted by the Institute for Energy Research and others, “U.S. oil production has had a significant moderating influence on global oil prices,” which has ultimately benefited American consumers.³³

This pattern has played out during previous major disruptions in global supply, notably disruptions in the Middle East and several Organization of the Petroleum Exporting Countries (OPEC) member nations in 2013–2014—which, at the time, were the worst disruption since the 1990 Iraqi invasion of Kuwait—and more recently with the 2019 Iranian attack on the world’s largest crude oil processing facility in Saudi Arabia.³⁴ As the EIA noted regarding the global supply interruptions of 2013–2014, “Record-setting liquid fuels production growth in the United States has more than offset the rise in unplanned global supply disruptions over the past few years” such that U.S. oil was “the main factor counterbalancing” supply disruptions in the global oil market.³⁵

Recommendations

While the United States cannot fully control the market price of oil or gasoline, policymakers are not helpless to affect the situation. To alleviate the price at the pump, policymakers in Congress and the President should:

- **Reduce barriers to oil production.** Policymakers should remove barriers to accessing and producing new oil supply on federal lands and waters as well as inefficient permitting processes that inhibit the construction of energy infrastructure connecting energy producers with customers. Regulations inhibiting access, production, and use of American oil should immediately be rescinded.³⁶ The process for leasing and permitting oil production activities offshore and on federal lands should be reformed.³⁷ Congress should improve the transparency and efficiency of federal permitting processes used to certify a variety of oil exploration, production, and pipeline activities.³⁸

- **Relieve burdens on refineries.** Refineries, which process crude oil into gasoline and other useable petroleum products, represent roughly 16 percent of the price of a gallon of gasoline and are an essential bridge between energy producers and customers. Congress should declare the mission of the Renewable Fuel Standard complete and end its continuance beyond 2022.³⁹ Until Congress ends the Renewable Fuel Standard, the Environmental Protection Agency should issue exemptions for small refineries without passing obligations onto larger refineries⁴⁰ and should state now that the volumetric quotas for ethanol and other renewable fuels will be zero beginning in 2023.⁴¹
- **Improve distribution.** Policymakers should address policies that inhibit infrastructure projects and improvements and increase the inefficiency and costs of delivering crude oil to refineries and ultimately to customers. Congress should repeal the Jones Act, which requires that goods delivered between two U.S. ports be conveyed by ships that are U.S. built, flagged, and crewed.⁴² President Biden should also immediately approve a cross-border permit for the Keystone XL Pipeline.
- **Strengthen partnerships with allies and trading partners.** The United States cannot isolate itself from global energy markets, and high demand and turmoil in Europe are contributing to the increased prices Americans are paying for gasoline. The United States should strengthen partnerships with allies and encourage trading partners to increase their own energy production. Expanding pipelines between Canada and the United States will help ensure a steady supply of oil to American and global markets.⁴³ Rather than seeking to increase global oil supplies by reopening relationships with the illegitimate government in Venezuela,⁴⁴ President Biden should seek to strengthen strategic and technical partnerships elsewhere in Latin America. President Biden should encourage Europe to become an energy-producing region again and should fully support the United States' commitment to the Three Seas Initiative to improve energy interconnections and infrastructure in eastern Europe.⁴⁵

Sending a Clear Message

Setting the mere expectation or possibility of increased production has in the past had a near-immediate influence on prices. The world saw this when President Bush lifted a moratorium on offshore oil production in July

2008, as observed by the Institute for Energy Research.⁴⁶ However, it is far from the only example where policy statements mattered.⁴⁷

Policy gimmicks under consideration by Congress would not address the root causes of gas price increases, and each would have counterproductive effects for the economy, including driving inflation even higher. A temporary gas tax holiday would be ineffective at reducing gas prices. A “windfall profits tax” on oil companies could devastate the oil and gas industry in the United States as well as the broader economy. Another round of monthly government checks to individuals would add even more fuel to the inflationary fire while also worsening America’s perilous financial condition.

Congress and the Biden Administration have a variety of serious options to relieve Americans from the high price of gas both in the short and long terms and to reduce global energy dependence on rogue regimes. These measures, rather than gimmicks that would sabotage energy production or make inflation even worse, are the real solution.

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