

Fuel Shock: How West Virginia Can Beat the High Cost of Gasoline

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Introduction

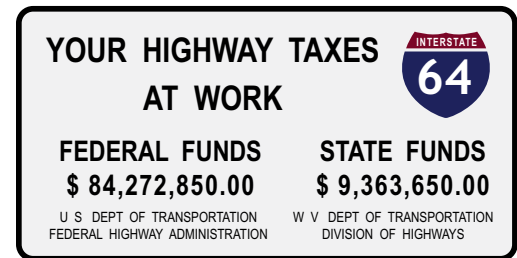
The start of summer brought with it increasingly high gasoline prices across the country. In West Virginia, consumers throughout the state watched as the retail price of gasoline soared past \$4 per gallon in June, and remained there for much of July. As a result, larger portions of family budgets were dedicated to paying for gas and driving patterns began to change.¹

During a Special Legislative Session in late June 2008, the Governor and the State Legislature responded to West Virginians' concerns with rising gasoline prices by freezing a portion of the state gas tax for one year. As a result, West Virginians who purchase gasoline were promised that this would put "more money back in their pockets."² However, there are several reasons why this is at best a short term solution that does not guarantee West Virginians any real savings and leaves them vulnerable to high gasoline prices.

The purpose of this report is to examine the implications of freezing the gas tax and to offer alternative solutions that could more effectively address the high cost of gasoline impacting West Virginians.

This report concludes that:

- Freezing the tax does not guarantee West Virginians real savings and leaves state residents vulnerable to future increases in gasoline prices. Studies in Illinois and Indiana suggest that the full value of the tax suspension will not be fully passed on to consumers.
- Suspending the gas tax fails to consider the impact of losing substantial state revenue that is used to maintain and construct West Virginia's network of roads. The construction and maintenance of these roads helps businesses in every sector of the economy, creates jobs and brings the state millions of dollars in federal funding that would otherwise not enter West Virginia's economy.



- Gas taxes are not the cause of high gasoline prices. In June 2008, when gasoline prices averaged more than \$4 per gallon, state and federal taxes combined represented only 1/5 of the total price.
- The Legislative decision to transfer \$40 million from the General Revenue Fund to the State Road Fund to pay for part of the lost revenue from the tax freeze means that non-drivers are helping subsidize both West Virginians who drive and the many non-West Virginians who use state roads.
- Better long-term options exist for providing West Virginians with relief from high gasoline prices. These include: the development of a mass transit system; the implementation of Pay As You Drive Auto insurance; granting tax credits for those who use alternative fuel and hybrid vehicles and for those who sell clean fuels; funding the research and development of clean vehicles and fuels; and, providing financial relief to low and moderate income families that suffer the most from high gasoline prices.

1 Despite the recent drop in gasoline prices over the last two months, the high cost of gasoline continues to be a large financial burden on West Virginia's families, and the various factors that can cause a jump in prices still exist.

2 West Virginia Office of Reference and Information, "Today in the Legislature: Lawmakers to Consider Gas Tax Freeze During Special Session," June 23, 2008.

The One Year Freeze Does Not Mean West Virginians Will Save Money at the Pump

Each January 1, West Virginia’s state gas tax rate goes into effect for the calendar year. The rate is set by adding together two components:

- a flat rate tax of 20.5 cents per gallon; and
- a variable sales and use tax that is equal to five percent of the average wholesale price of gasoline brought into the state between the previous year’s July 1 and October 31.

Chart 1 illustrates how West Virginia’s 2008 state gas tax rate was calculated. In 2007, the average wholesale price of gasoline between July 1 and October 31 was \$2.34.³ Five percent of this equals 11.7 cents. This rate was then added to the 20.5 cents per gallon flat rate to get the 32.2 cents per gallon rate, which went into effect on January 1, 2008. This is the second highest state gas tax rate in the country.⁴

CHART 1
West Virginia’s 2008 State Gas Tax Rate

GAS TAX COMPONENTS (per gallon)	TAX RATES (in cents)
Flat Rate	20.5
5 % of Average Wholesale Price	11.7
Total	32.2

Source: West Virginia State Tax Department

During the middle of June 2008, the average wholesale price of gasoline was \$3.34.⁵ If this rate remained constant from July-October, the average wholesale component of the state gas tax would have increased 5 cents to 16.7 cents. When added to the flat rate, this increase would have caused the state’s gas tax to rise to 37.2 cents on January 1, 2009.

In response to this likely tax increase, the Governor and the State Legislature chose to freeze the variable rate for the calendar year at its current level. This means that despite the average wholesale price of gasoline between July 2008 and October 2008, the variable rate will not change from the current 11.7 cents. Since the flat rate component does not change, the state gas tax rate will remain at 32.2 cents per gallon until at least January 1, 2010. The rationale is that lower gas taxes will result in lower gas prices at the pump for consumers. However, this is not necessarily true.

This is because the tax rate is levied by vendors who then incorporate the tax into pump prices. Since the vendors pay the tax and set the price per gallon of gasoline, the savings promised assume that they will pass the tax cut on to consumers. While there will be initial savings, it is unlikely that consumers will see the full value of the tax freeze.

According to a recent study by the Center for Energy and Environmental Policy Research, when Illinois and Indiana both suspended seven cents of their state gas taxes in 2000, prices only fell by an average of about four cents.⁶ The remainder of the tax cut benefit went to gas vendors via higher profits. Consequently, of the millions of dollars in revenue West Virginia will lose during the one year suspension, only a portion may benefit consumers. The remainder will go toward gasoline sellers profits.

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3 Charleston Gazette. “Gas Tax Could Rise 5 Cents,” June 16 2008

4 Motor Fuel Excise Tax Rates: January 1, 2008, http://www.taxadmin.org/FTA/rate/motor_fl.html

5 Ibid.

6 Doyle Jr. Joseph J, & Samphantharak Kristlet, “\$2.00 Gas! Studying the Effects of Gas tax Moratorium.”Center for Energy and Environmental Policy Research, December 2005.

In addition, West Virginia would have trouble mandating that sellers pass the full amount of the tax freeze benefit on to consumers. Since the price of gasoline fluctuates from week to week and varies from region to region, documenting the extent to which prices are reduced because of a tax freeze from what they otherwise would be is very difficult. Aside from blatant price gouging, it would be hard to prove that any gasoline seller in the state

profited from the tax freeze.⁷ For example, if the state gas tax is reduced by five cents and gas prices then decrease by only two cents, vendors can reasonably argue that prices would have increased 3 cents in the absence of the tax cut.

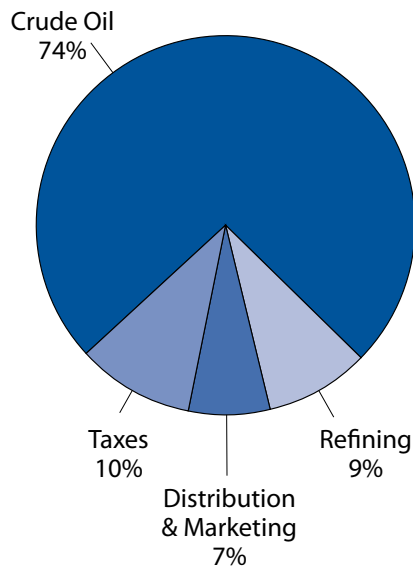
It is also important to note that even if gasoline prices do decline by the full amount of the tax decrease, there is no way to guarantee that the price decline might not have occurred anyway.

⁷ Johnson, Nicholas, "Should States Suspend Their Gasoline Taxes?" Center on Budget and Policy Priorities, September 8, 2005.

Gasoline Taxes Are Not the Cause of Rising Gasoline Prices

According to the U.S Department of Energy, federal and state taxes accounted for less than one-fifth of the price of gasoline in June 2008.⁷ As **Chart 2** illustrates, the remainder consisted of payments to crude oil producers (74 percent) plus the costs of refining (9 percent) and distributing and marketing (7 percent).

CHART 2
What We Pay for a Gallon of Regular Gasoline (June 2008)
 Retail Price; \$4.05 per Gallon



Source: United States Department of Energy

The cost of crude oil was the main catalyst for high gas prices during the early and middle parts of summer 2008. During this period, world crude prices soared to record levels due to high worldwide demand relative to supply.⁸ Gas prices were also responding to seasonal demand. Traditionally, higher demand by Americans during the spring and summer months cause the price of oil to average about five percent higher than during the rest of the year.

Chart 3 illustrates the marginal role that gas taxes play in the final price of gasoline by comparing costs in states that have varying state tax rates. While West Virginia has the second highest gas tax in the nation, the state's cost of gas varies only slightly compared to those with lower gas taxes.¹⁰ Note that the price per gallon of gasoline is more expensive in Connecticut, despite it having a lower gas tax than West Virginia.

The reason for these differences is that gasoline prices vary depending on the region of the country. While state gas tax rates certainly factor in to these regional and state differences, it is important to note that there a variety of other factors that contribute to why gasoline prices are higher in some states and regions than in others. These include: the distance from supply; possible supply disruptions; retail competition and operating costs; and, environmental programs that raise the cost of producing, storing and distributing gasoline. Collectively, these factors establish the price of gasoline in different markets across the country.

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CHART 3

State	State Gas Tax Rate (cents per gallon)	Average Price of Gasoline (dollars per gallon)	Difference from West Virginia (cents per gallon)
West Virginia	32.2	4.041	n/a
Virginia	17.5	3.919	(.122)
Connecticut	25.0	4.293	.252
Wisconsin	30.9	3.935	(.106)

Source: Federal Transportation Administration and AAA Daily Fuel Gauge Report, July 25 2008

8 Energy Information Association, <http://tonto.eia.doe.gov/oog/info/gdu/gasdiesel.asp>
 9 Id. at http://tonto.eia.doe.gov/ask/gasoline_faqs.asp#tax_gallon_gas
 10 AAA Daily Fuel Gauge Report for July 25, 2008, <http://www.fuelgauge.com/sbsavg.asp>

Suspending the Gas Tax Fails to Consider the Impact of Losing Substantial State Revenue

The West Virginia Division of Highways relies almost exclusively on the State Road Fund to build and maintain approximately 92 percent of the state’s highway system.¹¹ The quality of these roads enable West Virginians across the state to enjoy a higher quality of life by providing them with safe and efficient access to a variety of social, economic, educational and recreational opportunities.

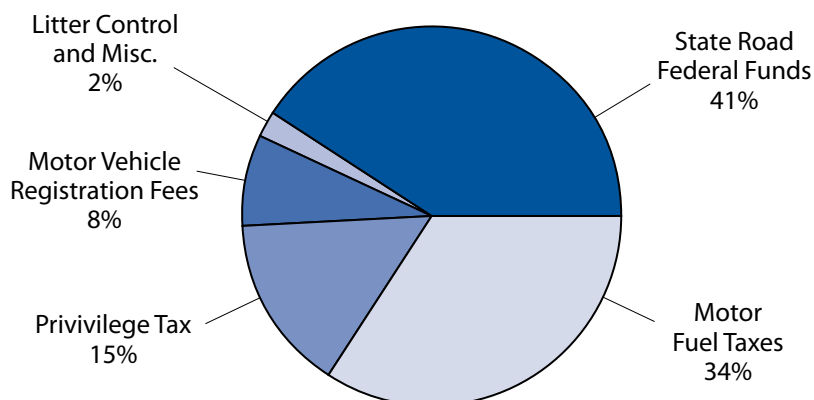
Motor fuel taxes are a major source of revenue for the State Road Fund, accounting for \$430,612,000, or 33.8 percent of its total revenue. This amount is second only to federal funding. **Chart 4** illustrates the percentages of the various revenue sources that accounted for the Governor’s estimated Fiscal Year 2009 State Road Fund.

Prior to the tax freeze, the West Virginia Division of Highways projected that available revenue in the State Road Fund will be inadequate to “satisfactorily achieve its mission of maintaining a safe and efficient highway

system” and that “system preservation needs are not being met and as a result, highways are deteriorating.” For example, current maintenance need on state roads include \$2.5 billion dollars to replace all state-maintained bridges and over \$100 million for annual paving.¹²

In addition, more than \$25 billion in needed new construction cannot be undertaken due to a lack of revenue. Since the maintenance of existing infrastructure takes precedent over new construction, it is likely that most of these projects will never commence.

CHART 4
State Road Fund Sources of Revenue
 1.274 Billion (Estimated)



11 West Virginia Department of Transportation, FY 2009 Budget Presentation.

12 Ibid.

Source: West Virginia Executive Budget 2009, Vol. 1

Compounding the revenue shortfall problem is the Division of Highways' dwindling purchasing power. The costs of maintenance and construction continue to grow rapidly as the prices of steel, concrete and oil petroleum-based products increase. However, major revenue sources for the State Road Fund like the state gas tax have not been adjusted to keep up with inflation. This means that as the costs of maintenance and construction rise, the amount of work that can be completed with projected revenue decreases. According to recent projections, the State Road Fund's purchasing power, when adjusted for inflation, will shrink nearly 25 percent from Fiscal Year 2008 to Fiscal Year 2013.¹³

In the wake of these revenue shortfalls, suspending the state gas tax for one year will add an even greater burden on the Division of Highways' ability to provide an adequate and safe system of roads in West Virginia.

The construction and maintenance of roads in West Virginia helps businesses in every sector of the state economy. According to a recent West Virginia University study, "for every \$1 million of highway construction, there are fifteen jobs created, with \$485,000 in employee compensation, and an additional \$900 thousand of business sales in the state."¹⁴

Conversely, not properly maintaining roads or beginning new construction will have a

negative economic impact on the state. The existence of an efficient network of roads that connects different areas of the state to one another is vital to West Virginia's economy. Decreasing various construction and paving programs will endanger the continued growth and quality of these roads. In turn, this will reduce the number of projects that are awarded to private contractors and consulting firms, and may cause a reduction in their workforces.

Highway projects also bring the state millions of dollars in federal funding that would otherwise not enter West Virginia's economy. As **Chart 5** illustrates, federal funds account for 41.6 percent or \$529,984,000 of the appropriated Fiscal Year 2009 State Road Fund. The amount of federal dollars given to the state is based on ratios that match the state's fiscal contribution to construction and maintenance projects.

Federal dollars for the State Road Fund are received directly from the federal government and may only be used for road construction, reconstruction and maintenance. For interstate projects, West Virginia gets a 9-1 match from the federal government. This means that for every dollar the state spends on road construction, it gets nine dollars from the federal government. Projects that do not fall under Interstate Aid receive 8-2 matches. Chart 5 lists the different forms of federal aid, their matching ratio and their estimated total in the State Road Fund for Fiscal Year 2009.

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CHART 5
State Road Federal Matching Aid Amounts

Form of Federal Aid	Match	Estimated Total FY 2009
Interstate	9-1	\$72,700,000
Other Federal Aid	8-2	\$286,500,000
Appalachian	8-2	\$128,200,000

Source: West Virginia Department of Transportation Fiscal Year 2009 Budget Presentation

¹³ Ibid.

¹⁴ Ibid.

Subsidizing Those Who Drive

In order to offset a portion of the revenue that will be lost during the gas tax suspension, \$40 million will be transferred from the General Revenue Fund to the Road Fund. The General Revenue Fund raises money primarily through income and sales taxes; this means that non-drivers are helping subsidize both West Virginians who drive and the many non-West Virginians who use state roads. This is \$40 million that could be spent on developing alternative forms of transportation to decrease West Virginia's dependence on gasoline.



Better Options Exist to Address High Gasoline Prices and Oil Dependence

West Virginia is among the most oil dependent states in the nation, yet it is also one of the states doing the least to reduce its reliance on gasoline.¹⁵ The Natural Resources Defense Council recently ranked West Virginia as the country's 11th most oil dependent state. In 2007, West Virginians spent an average of \$1822.74, or 6.17 percent of their income on gasoline. The study also ranked the state 7th worst in terms of taking proper action to address this high level of dependence.

Suspending the state gas tax will not bring sustainable relief from high gasoline prices to West Virginians. However, there are workable solutions the state can take to break its dependence on oil and in doing so, ease the economic pressure many in the state are feeling from rising fuel costs.

The Development of Mass Transit

A majority of commuters in West Virginia rely on their personal vehicles to get to work each day.¹⁶ As the price of gasoline hovers near \$4.00 per gallon, these daily commutes continue to severely cut into family budgets. The development of an easily accessible mass transit system would provide West Virginians with an alternative to driving long distances to work, promote energy dependence and decrease the state's average vehicle-miles traveled (VMT). It would also be an important transportation alternative for many West Virginians as gas prices rise.

A regional rail system would provide this alternative for commuters by connecting various areas of the state to one another. Similar transit projects are already moving forward across the country. For example, Denver, Colorado recently developed a 14-mile Light Rail Transit system with over 22,000 riders using the system on an average workday.¹⁷

Different regions of the state may have the potential demand to support a rail system. These include:

- the Eastern Panhandle;
- the Northern Panhandle;
- North Central West Virginia (Morgantown to Clarksburg);
- Charleston to Huntington; and,
- Princeton to Bluefield.

Pay As You Drive Auto Insurance (PAYD)

A number of states have allowed insurance companies to offer mileage-based insurance premiums to drivers. This type of premium is commonly known as Pay As You Drive Auto Insurance (PAYD). As opposed to the traditional form of auto insurance where drivers pay lump sum amounts regardless of how many miles they drive, PAYD charges a premium based on the number of miles that are actually driven. The program is designed to incentivize drivers to drive less and shift the cost of driving to those who are more high-risk because they drive more.

15 Gardiner, David & Associates LLC. "Fighting Oil Addiction: Ranking States' Oil Vulnerability and Solutions for Change," Natural Resources Defense Council, July 2008.

16 "West Virginia Economic Summary," Workforce West Virginia April 2008.

17 "State Policies for a \$4/ Gallon World," Stateside Dispatch, June 9, 2008.

According to a recent study, there are numerous environmental and social benefits to implementing PAYD. If PAYD were in effect nationwide driving would decline by an estimated 8 percent, which would net society the equivalent of \$50 billion to \$60 billion a year by reducing driving-related harms. Other benefits include roughly reducing carbon emissions by 126 million tons per year and reducing car insurance premiums for nearly 2/3 of all households.¹⁸

Similar to current insurance systems, PAYD would recognize additional risk factors, such as location, age, gender, driving record and vehicle characteristics that will affect the per-mile price. For example, a driver with a history of accidents would still pay more than a driver with a good record, all else being equal. To capture mileage, an annual reading could be done at a service center, by the insurance agent, or at garages licensed to do state inspections.¹⁹

Due to these additional risk factors used to calculate the per-mile price, PAYD would not adversely affect those who drive more because they live in rural areas. Drivers in urban areas are more likely to get in car accidents and will pay more as a result. Equally, since rural drivers get in fewer accidents due to driving on less populous roads, they will pay less.

According to the Brookings Institution, “since geography is a key risk factor, those who live in rural areas where people drive more will not be unfairly impacted because their premiums will be determined relative to how many miles the average driver in their areas drives.”²⁰

West Virginia requires drivers to be insured at all times, and under PAYD it is possible for a driver to lose their insurance by exceeding the prepaid amount of miles. Therefore, it would be necessary for an insurer to create a PAYD premium to ensure that a driver is never uninsured.

Tax Credits for Clean Vehicles and Clean Fuels

Unlike a number of other states, West Virginia does not currently offer tax incentives to its citizens who purchase clean vehicles. Presently, fourteen states offer financial incentives for those who purchase new hybrid-electric and plug-in hybrid cars and trucks. Hybrid vehicles not only benefit the environment by emitting less global warming pollution, but they also save owners money by using less gasoline than traditional vehicles. States commonly offer an income tax credit for the incremental cost of purchasing a hybrid vehicle or converting a current vehicle to operate on an alternative fuel source.

An additional twenty-nine states offer incentives for selling bio-fuels. These tax credits provide important financial support to help build the infrastructure that will make these fuels more readily available for consumers. For example, Maryland offers 20 cents per gallon credits to state certified producers of ethanol and biodiesel production.

Research and Development

Funding to support the research and development of clean fuels and clean vehicles through grants and fellowships will help reduce oil dependence in the near future. For example, Illinois currently funds a research program designed to promote and expand the use and commercialization of clean, renewable transportation fuels. Programs like this will accelerate the creation of alternative fuels and efficient hybrid vehicles by providing financial incentives for scientists to conduct research. For example, Pennsylvania provides grant funding for projects to develop bio-fuels and alternative to diesel fuels for heavy trucks.

18 Bordoff, Jason & Noel, Pascal, “Pay-As-You-Drive Auto Insurance: A Simple Way to Reduce Driving-Related Harms and Increase Equity,” The Brookings Institution, July 2008.

19 Boettner, Ted. “Could Auto Insurance Save the Planet?” West Virginia Highlands Voice, January 27, 2007

20 Bordoff, Jason & Noel, Pascal, “Pay-As-You-Drive Auto Insurance: A Simple Way to Reduce Driving-Related Harms and Increase Equity,” The Brookings Institution, July 2008.

Targeted Relief to Low and Moderate Income Households

If state policy leaders want to offer relief from high gas prices to West Virginians, they could target the relief to low and moderate income households via refundable tax rebates, based on their estimated gas tax expenditures. For example, West Virginia could calculate that an average family spends \$20 per person on gasoline taxes and then distribute rebate checks in that amount. This would provide relief to those who need it most, without jeopardizing the revenue stream that is used to maintain the state's network of roads. Granting specific relief would also allow the state to continue promoting policies that encourage West Virginians to reduce their dependence on oil.

An additional option could be the implementation of a State Earned Income Tax Credit (SEITC) in West Virginia, which would provide direct financial assistance to 145,000 low and moderate income working families.²¹ This approach would benefit both the West Virginians hit the hardest by high gas prices and provide for the same level of assistance to families who take measures to reduce their gasoline consumption as the families that do not.²²

21 A refundable SETIC set at 20 percent of the federal credit would build on the strength of the federal EITC by bringing an additional \$50 million to more than 145,000 low income working families, providing an average benefit of \$350.

22 Johnson, Nicholas, "Should States Suspend Their Gasoline Taxes?" Center on Budget and Policy Priorities, September 8, 2005.

Conclusion

The state needs to develop long term policy initiatives that can help West Virginians adjust to a world with expensive gasoline. To do this, state leaders must step away from short term solutions like temporarily suspending the state gas tax and commit to policies that will help end West Virginia's dependence on oil. This includes investing in long term policies that promote the use of alternative energy sources, more efficient vehicles renewable energy and conservation.

The **West Virginia Center on Budget and Policy** is a policy research organization that is nonpartisan, nonprofit, and statewide. It focuses on how policy decisions affect all West Virginians, especially low- and moderate-income families.

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