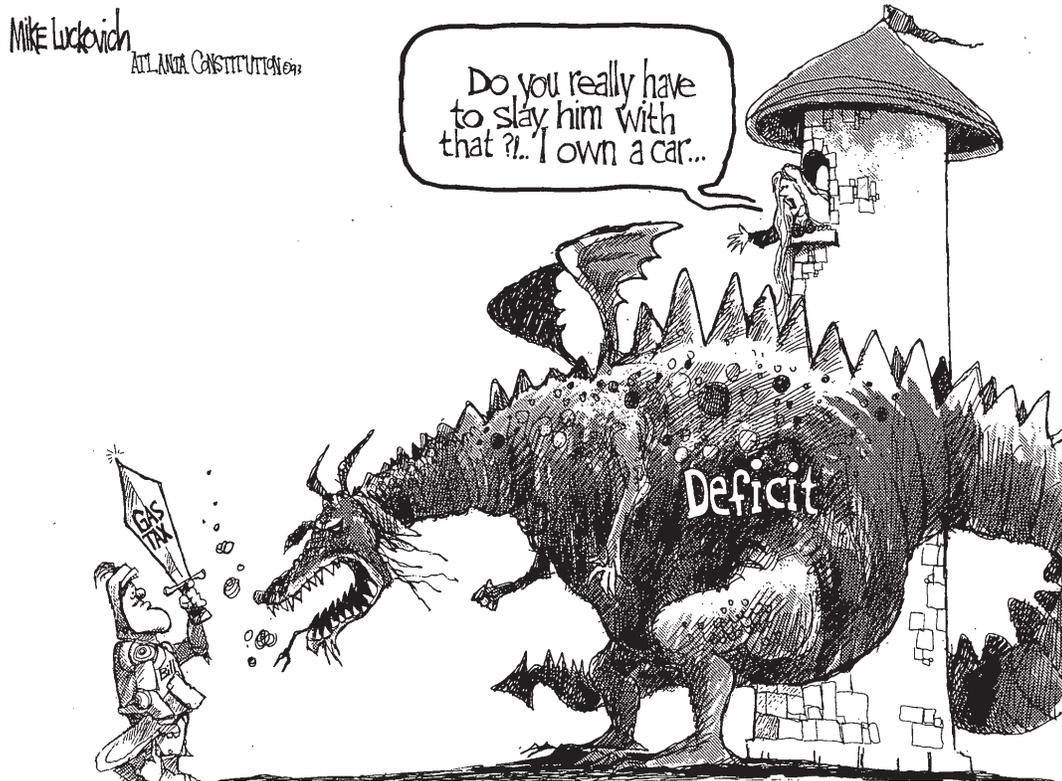


Resource 3 (1 of 5)**Perspectives and Evidence on the Gasoline Tax**

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Look carefully at the words and images in the cartoon and think about what it is saying about the gas tax, specifically, and how taxes influence behavior, more generally. The “deficit” label on the dragon refers to the amount government spending exceeds revenues in any given year, which can be reduced by increasing taxes or lowering spending. Which of these interpretations of the cartoon comes closest to your own? Discuss what you find with a partner. If you do not agree on the best interpretation, try to convince one another of your position until you come to agreement.

Interpretation 1: The car can be used to defeat the dragon; this means the government can invest in transportation spending to help the economy grow. This will reduce the deficit.

Interpretation 2: The gas tax will not be enough to fight the deficit, because the dragon is so large. It might be easier to just escape the problem of a deficit with the car.

Interpretation 3: The government wishes to raise sufficient revenue with taxes to combat the deficit, but many taxes, including the gas tax represented by the sword in the cartoon, are politically unpopular. Voters essentially want government spending and do not want deficits, but believe that other people and other things should be taxed, besides the things they do.

Resource 3 (2 of 5)**Perspectives and Evidence on the Gasoline Tax**

The Costs of Taxation

In economics, a *cost* is what you have to give up to get something. In general, then, a cost is something that is undesirable and that we seek to minimize.

Direct Cost

The direct cost of taxation is the loss of income by the taxpayer.

- ▶ Why is this a cost?
- ▶ Why would someone seek to avoid it?

Indirect Cost

The indirect cost is not observed. Instead, it is hypothetical—an estimation of what would have been if not for the tax. Taxes have two indirect costs:

- The government does not necessarily choose to spend things on what people want, or in a way that gives them as much satisfaction (in economics terms, *utility*) as if they got to spend the money exactly as they pleased.
 - Taxes can reduce *incentives* to do positive things and increase incentives to do negative things. In economics, an incentive is something that makes us want to do something.
- ▶ Can you think of an example of a way that a tax might reduce the incentive to do something good?
 - ▶ Can you think of an example of a way that a tax might produce an incentive to do something bad?

So, how do we minimize the costs?

The government tries to offset the direct cost by providing benefits, in the form of spending on public goods and services that provide people with utility.

- ▶ Can you think of an example of a benefit like this?

One way to reduce the indirect costs is by lowering taxes on things we wish people to do more and raising taxes on things we wish people to do less. An example of the first is that the government attempts to encourage giving to charity by reducing taxes for those who give a lot. An example of the latter is taxes on cigarettes, which the government uses to discourage smoking.

- ▶ Can you think of other examples?

Resource 3 (4 of 5)**Perspectives and Evidence on the Gasoline Tax**

Three Perspectives on the Gas Tax**Perspective 1**

The federal taxes on fuel in the United States currently stand at 18.4 cents per gallon of gas and 24.4 cents per gallon of diesel. The average combined state and federal taxes across the country is 27.2 cents per gallon of gasoline. With gas prices above \$3 per gallon in almost all areas of the country congress should immediately move to eliminate all federal gas taxes and eliminate federal funding for road projects.

Gas taxes were intended as a “user fee” in this country to fund the Federal Highway Trust Fund. The idea behind this tax is the more you drive the more you pay in taxes that fund road projects. Although the concept seems like a good idea in theory, in reality the funds are being wasted and raided for other projects. Just as the Social Security Trust fund is simply an old shoe box full of IOU’s at this point, the Highway Trust Fund is also broke. In 2008 the fund required an \$8 billion infusion of money from the government’s General Fund. . . .

Like most “user fees,” federal gas tax revenue depends on a variety of factors including how much we drive, how much fuel our cars burn, and the overall economy. The current recession has led to a sharp decrease in the number of miles driven, gasoline sold, and taxes collected compared to five or ten years ago. Although many road projects are planned years in advance the government has no solid method of predicted trust fund revenues in the future.

As much as we like to believe that cars and trucks are evil pollution generating devices, the fact is our economy requires driving in order to function. I don’t care how “green” of a life you live, I guarantee those green products you are using were shipped by road and fuel-consuming trucks.

Source: DF. (2012, February 4). Eliminate federal gas taxes [Web log comment]. Retrieved from <http://www.redstate.com/whatevrworks/2011/02/04/eliminate-federal-gas-taxes/>

Perspective 2

. . . The demonization of smokers has been so successful that fewer and fewer people smoke. You’d think that was a good thing, but now fewer and fewer people are paying cigarette taxes, leading to less revenue in government coffers. Likewise, those nasty buyers of hybrid vehicles, with their care for the environment and desire for high fuel efficiency, are forcing lawmakers to consider taxing by the mile to offset the reduction in gasoline taxes. Faced with the success of their policies, now they want to go after alcohol, or I should say, further after alcohol, because it is typically already given its own excise and “sin” taxes.

But is this the right thing to do? Is it legitimate, in the spirit of America’s founding, for the majority to decide that certain activities are “bad” or “good,” and thus should be taxed at higher or different rates than others? Is it legitimate, in a country where we supposedly have “equal protection under the law,” that some people and activities are just more “equal” than others?

Source: Warbiany, B. (2005, September 23). Taxes as behavior modification [Web log comment]. Retrieved from <http://www.fairtaxblog.com/20050923/taxes-as-behavior-modification/>

Resource 3 (5 of 5)**Perspectives and Evidence on the Gasoline Tax**

Perspective 3

Harvard economist N. Gregory Mankiw argues in favor of targeted taxes, such as sin taxes on things like cigarettes and user taxes on things like gasoline. These taxes impose the costs of a behavior—increased healthcare costs in the case of smoking and increased road maintenance costs in the case of driving and using gasoline—directly on those doing the behavior. This lowers the concern about taxes distorting incentives, because the incentive created is to reduce the behavior that would otherwise create a cost for society. Furthermore, the revenue generated by the tax can be used to reduce other taxes, which do create disincentives for desirable behavior like working, saving, and investing. In Mankiw's words:

There is, however, a simple way to remedy the market failure and restore the optimality properties from the fundamental welfare theorem: Individuals can be charged for the external costs they impose on others (and subsidized for the external benefits they give to others). The solution goes back to Arthur Pigou, the British economist from the early 20th century, who was sometimes friend and sometime nemesis to his more famous colleague John Maynard Keynes. In his honor, these corrective measures are called Pigovian taxes.

For at least two reasons, Pigovian taxes are popular among economists. First, they are often the least invasive way to remedy a market failure. They can restore an efficient allocation of resources without requiring a heavy-handed government intervention into the specific decisions made by households and firms. Second, they raise revenue that the government can use to reduce other taxes, such as income taxes, which distort incentives and cause deadweight losses.

Source: Mankiw, N. G. (2009). Smart taxes: An open invitation to join the Pigou club. *Eastern Economic Journal*, 35, 14–23. Retrieved from http://scholar.harvard.edu/files/mankiw/files/smart_taxes.pdf