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As fuel taxes dip, will road funding suffer?

Summary: Recent *Policy Briefs* have documented the impact of the pandemic lockdown on statewide tax revenues and what that means going forward. These *Briefs* have analyzed turnpike toll revenue, gaming tax revenue and general fund revenue. While the percentage drop in general fund revenue was not as severe as the other two, the decline is large enough to require hard decisions to be made in the upcoming budget talks as the interim budget is set to expire at the end of November.

This *Brief* examines the effect the lockdown on motor license fund revenues, specifically the three petroleum-based taxes of the oil company franchise tax, the Act 89-fuels tax (diesel) and the Act 89-liquid fuels tax (gasoline) which fund highway and bridge improvements, among other things.

The oil company franchise tax imposes a tax on "all oil companies conducting business in Pennsylvania for the privilege of exercising their corporate franchise, doing business, employing capital, owning or leasing property, maintaining an office or having employees in the Commonwealth" (*Pennsylvania Tax Compendium, Department of Revenue*). Act 3 of 1997 imposed a tax on liquid fuels (153.5 mills) and fuels (208.5 mills) on a cents-per-gallon equivalent based on the wholesale price per gallon of $1.25 on distributors.

Act 89 of 2013 raised that wholesale price floor to $2.99 per gallon and then added additional mills, lifting the tax to 192.5 mills on liquid fuels and 247.5 mills on fuels effective January 2020. *(Pennsylvania Bulletin, Vol. 49, No. 50*). On a cents-per-gallon basis distributors pay 57.6 cents per gallon on liquid fuels and 74.1 cents per gallon on fuels as of January 1, 2020. However, most, if not all, of the tax is ultimately passed on to the consumer.

The revenue from the oil company franchise tax is split into three categories: the original tax, 45.9 cents per gallon on liquid fuels and 62.4 cents per gallon on fuels, referred to as the "first sale" to a "wholesale or retail dealer, consumer or direct use in the Commonwealth of petroleum products occurring immediately after importation or production (*Pennsylvania Code, Chapter 351*)." Then there are the Act 89 add-on mills for both liquid fuels and fuels (11.7 cents per gallon) charged at the point of retail. The proceeds from all are placed in the motor license fund and are restricted to certain highway activities such as maintenance and construction.

Oil company franchise tax

For the 2020 fiscal year (July 2019 to June 2020) the oil company franchise tax brought in $931.4 million—7.4 percent *lower* than the estimated $1.005 billion than the state originally forecast for the budget. Because the lockdown only covered slightly more than the last quarter of the fiscal year (mid-March through June) the fiscal year's total revenue was buoyed by the first eight-plus months of strong revenues. Through February the oil company franchise tax was running 1.7 percent ahead of projections and one percent better than the previous fiscal year.

But in March revenue from this tax began to dip as the lockdown commenced and fell 14 percent below February's level. Still, the revenue was marginally higher than March 2019's collections. Revenue revived somewhat in April, perhaps on optimism that the lockdown would be short-lived. But the April uptick was short-lived as May's collections dropped dramatically, falling 66 percent from April's revenues ($26.5 million vs. $77.7 million) and was 68 percent lower than the tally in May 2019 ($81.9 million).

Keeping in mind that this is a tax on importation and production and not on retail, the reality of the lockdown may have caused oil companies to slow production or importation in May. In June, as the lockdown began to relax, the revenue ticked up a bit to $56.4 million but was still 32 percent lower than in June 2019 ($83.3 million), perhaps reflecting an expected muted summer driving season. Unfortunately, July's data that would shed light on possible improving market conditions is not yet available.

Fuels tax

At the retail level, revenue from the fuels tax (diesel) remained the strongest relative to forecasts. This is undoubtedly due to the fact that most delivery vehicles use diesel and those vehicles were still very busy even during the most severe weeks of the lockdown. Moving supplies to grocery stores, service stations, building supply and general merchandise stores and manufacturers allowed to operate went on largely unabated. In February, the fiscal year-to-date revenue collection from the fuels tax reached $98.41 million. This was 2.1 percent ahead of the estimated $96.4 million and just slightly lower than the February year-to-date of the previous fiscal year.

The lockdown notwithstanding, March 2020 revenue was higher than the year-earlier collection. However, that was the last month of the fiscal year that was greater than its year-earlier count. Compared to the same month a year earlier, April's revenues were down 1.3 percent; May's collections were 7 percent lower and June's fell by 18 percent.

All told, the revenue from the fuels tax finished the fiscal year at $142.1 million, just under the estimated amount of $142.9 million. The strong performance in the first three quarters kept the 2020 fiscal year decline from being worse.

Liquid fuels tax

The liquid fuels tax from Act 89 is also paid at the retail level and has taken a harder hit than the fuels tax, perhaps because it mirrors travel in gasoline-fueled vehicles—either for work or leisure.

Revenue for the 2020 fiscal year fell almost $30 million short of the budget estimate ($493 million vs. $522.5 million). It finished behind the previous fiscal year by 8.1 percent.

Through the first three quarters of the fiscal 2020 (July 2019 through March 2020), the Act 89 liquid fuels tax garnered $395.4 million. In fiscal 2019 that amount was $357.5 million. Thus, the first three quarters of fiscal 2020 collected $37.9 million more than the previous fiscal year (10.6 percent). One reason is an anomaly in August 2019 which the Department of Revenue records a *negative* $2.995 million. The explanation was that money was moved from August to correct for delayed funding for June and July. Without the transfer, the fiscal year would have ended with increases over the estimated amount and the previous fiscal year (6 percent and 3.3 percent respectively).

The final quarter of the fiscal year—April, May and June—was, not surprisingly, lower than that of fiscal 2019. This final quarter of 2020 was 11.3 percent off the final quarter of 2019 ($158.5 million vs. $178.7 million). A large part was due to the lockdown which forbade non-essential travel for most of the quarter while some can be attributed to reporting delays as companies may not have had personnel in place to report/pay the tax on time.

In sum, all three petroleum-based fuels taxes—the oil company franchise tax, the Act 89-fuels tax and the Act 89-liquid fuels tax—had revenue declines in fiscal 2019-20. As stated in the Pennsylvania code, these taxes are designated for highway maintenance and construction and, unfortunately, for the foreseeable future, those revenues are likely to fall short of the levels they would reach absent the Covid-19 restrictions imposed by the state.

For many years the Institute has advocated repealing the state's prevailing-wage requirement on public construction including highway maintenance and construction. Pennsylvania's prevailing-wage law mandates that the Department of Labor and Industry set a wage minimum to be paid on projects receiving government funding (in any form). That minimum is typically (and artificially) defined as the union wage.

While most contractors pay a similar wage, the added mandate of paying a cash rate for fringe benefits, if a benefit package is not being offered, can keep non-union firms from bidding. The cash rate paid by a non-union firm is then subject to all payroll taxes whereas a union shop that shares in a large benefit plan is not required to pay these extra taxes (*see Policy Brief Vol. 18, No. 25 for more details*).

The presence of the prevailing-wage law keeps non-union firms from bidding on projects. And if they do win a contract and pay the higher mandated rates, those costs simply get passed on to the taxpayers who are funding them through the taxes collected. Removing the prevailing-wage mandate will result in significantly lower costs for highway maintenance and construction projects and allow all levels of government to stretch limited highway dollars that much further.

The pandemic has caused everyone to rethink how things are being done. The time has come to end Pennsylvania's prevailing-wage mandate.

Frank Gamrat, Ph.D., Executive Director

Allegheny Institute for Public Policy
305 Mt. Lebanon Blvd.* Suite 208* Pittsburgh PA 15234
Phone (412) 440-0079
E-mail: aipp@alleghenyinstitute.org
Website: www.alleghenyinstitute.org
Twitter: AlleghenyInsti1