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Taxes, Crude Oil and Volatile Gasoline Prices

Energy and fuel prices are a highly visible component of the nation's economic picture and any upward fluctuation is likely to bring a spate of crisis mongering and finger pointing by liberal commentators. For example, Public Citizen President Joan Claybrook claims: "The Oil Companies try to blame OPEC for high gasoline prices, but their record profits show that they are the ones taking money from the pockets of the American consumers," and commenting further adds: "They cannot continue to blame others for the high price of gas and claim that they aren't culpable in this huge consumer rip-off." Such utter nonsense.

Rather than trying to understand the mechanisms driving gasoline prices, it is all too easy for some people to simply blame the oil companies. While there may have been a temporary boost in profits, that is not the principal cause of gasoline price changes. An understanding of the components of gasoline prices is essential in order to comprehend what has been at work during recent periods of spiking pump prices. Unfortunately, "advocates" like Public Citizen cloud the issue with one-dimensional analyses that invariably blame "greedy capitalists."

First of all, the truth is that, adjusted for inflation (using constant 2000 dollars), U.S. gasoline prices have declined almost continuously since 1918. The exceptions are extraordinary spikes in prices during the 1930s, from 1974 through 1985 and in 2000. Still, there is no question that Americans enjoy remarkably low energy prices. And rather than gouging as its critics claim, fuel industry profits as a percentage of sales are in line with other US industries. The major fuel producing companies averaged a 6.6 percent net income margin in 2000 before moving temporarily higher to 8.3 percent in the first half of 2001 owing to tight supplies and allocation problems. Even at 8 percent, the fuel industry profit margin pales in comparison to several others, including banking and medical products. Moreover, the recent fuel industry spike must be viewed in the context of the three-year period 1998 through 2000 when the industry had a net income margin of 4.6 percent, well below the U.S. all-industry average.

Price Movements

Regarding movements in gasoline prices, it is important to remember the three cost components of the pump price: crude oil, refining and marketing (including profits), and taxes. Consider the inflation-adjusted comparisons of 1980 and 2000-2001 in the following table. In 1980, the U.S. average pump prices, taking into account all grades and formulations were valued at $2.51 (in 2000-2001 dollars). The average price over the 12 months ended in April 2001 was $1.57 per gallon, almost 40 percent below the 1980 price. Bear in mind too that prices have fallen significantly since April of this year, making the 20-year comparative price decline even more dramatic.

Components of Retail Gasoline Prices*
(Inflation Adjusted to 2000-2001 prices per gallon (national averages))

	1980	2000-2001 Average	20 yr. Change
Crude	$1.38	$0.66	-$0.72
Refining and Marketing	$0.85	$0.49	-$0.36
Taxes	$0.28	$0.42	$0.14
Pump Price	$2.51	$1.57	-$0.94
Taxes as a Share of Retail	11%	27%	na

* Source: API Consumer Information

Examining changes in gasoline price components over the past 20 years is enlightening. For example, the cost of crude per gallon has fallen by over 50 percent while refining and marketing costs (including profits) declined by over 40 percent. Taxes are the only component of the pump price to have risen, climbing 50 percent, and now account for almost 30 percent of the retail price compared to just 11 percent in 1980. Moreover, as pump prices continue to decline, the tax share of retail prices will rise. Meanwhile, the 20-year decline in refining and marketing costs in real terms is a remarkable performance by refiners and distributors in increasing productivity, and a remarkable testament to competition, which has restrained the ability of companies to increase profit margins.

Pennsylvania Situation

While not among the lowest prices in the country, Pennsylvania gasoline prices are much better than several states as shown in the table below.

Retail Gasoline Prices per Gallon (All Grades)

		TAXES (In Cents)			
	Excluding all taxes	State	Federal	Pump Price	Tax share of retail
Pennsylvania	$1.196	25.9	18.4	$1.639	27 %
Maryland	1.243	23.5	18.4	1.662	25
West Virginia	1.270	25.4	18.4	1.708	25
New York	1.246	28.2	18.4	1.712	27
Ohio	1.375	22.0	18.4	1.779	23
Illinois	1.500	30.1	18.4	1.985	24

(Source: US Department of Energy, May 2001)

Pennsylvania levies 25.9 cents in taxes on each gallon, adding nearly 22% to the current price of a gallon of gasoline here. States impose an average 23.5 cents in taxes per gallon. As of April 2000, Pennsylvania ranked 12th highest in total taxes on gasoline, just above West Virginia, and below Michigan.

Regional variations in gasoline prices reflect differences in regulatory requirements and the ability to supply markets from existing refineries. States that impose high income and property taxes on business and impose stiffer regulatory costs will have higher production and distribution costs. There is no mystery about gasoline prices nor is there any justification for scapegoating. Rather than vilify energy suppliers, pundits and consumer advocates ought to praise a market system that is still working well despite attempts to impede or replace market forces by government fiat.

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