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The true worth of the gas tax holiday proposals

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Everybody and their cat have had the opportunity to trash the gas tax holiday plans being bandied around these days.

There is consensus among most economists that the plan would not work its intended magic, i.e., lower prices paid at the pump by anything even close to the 18.4 cents that one pays in federal excise tax per gallon.

Although there is a legitimate discussion on whether savings of \$20, \$30 or even \$70 per car would make a noticeable difference for less well-off households, the debate about the efficacy of the proposal itself is over.

An undisputable importance of these initiatives, however, lies in their educational merit. One of the most important insights taught in economics 101 is that "Tax incidence is independent of tax law."

The former is the question of who actually has to bear the burden of tax in terms of higher prices paid (consumers) and/or lower prices received (suppliers).

The latter, the tax law, describes who is responsible for transferring the tax receipts to the government coffers.

A sales tax, for instance, is being levied by law on the seller, but it needs little scrutiny to arrive at the conclusion that consumers bear some burden, too.

What economic analysis can show is that in most cases the tax will impose burdens on both sellers and buyers - and that they will remain the same no matter who is legally responsible for getting the tax receipts to the government.

What then, if not the letter of the law, determines how the tax burden is shared? The answer is "elasticity." This concept, in layman's terms, describes the ability of both sellers and consumers to change their behavior in response.

One just has to imagine a bustling marketplace in which a tax is suddenly imposed.

The market participants will try to (legally) "evade" the tax, say, by purchasing or producing comparable products that are not being taxed or by decreasing the amounts traded.

It's like the old joke of two people running away from an angry bear (or dog, or lion). One does not have to

outrun the animal to be safe, just the other person.

Consequently, those who are less nimble or able to legally "scamper away" from the tax are the ones bearing most of the tax burden.

And that brings one back to the gas tax holiday idea. Governments at all levels - knowing their economics - often tax most heavily those goods for which demand is inelastic, i.e., households do not have many viable alternatives.

Examples include alcohol, tobacco and, of course, gasoline.

Thus it is likely accurate that most of the burden of the federal excise tax on gasoline is being borne by consumers.

However, a host of complexities of the gasoline market that make this true also signal that oil-producing firms would face few obstacles to raising prices after the tax is removed, especially if they - ostensibly - are being forced to make up the tax-revenue shortfall.

Political campaigns should be about educating the public. If nothing else, the gas tax holiday proposals fulfill that pledge.

They carry the message to always be wary when a "tax salesman" promises that somebody else will be burdened by a tax (holiday) or some regulation: Most of the time, the truth hits way closer to one's own wallet.

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