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Broad Tax Cuts for Gasoline Are the Wrong Way to Go

In view of drastic rises in energy prices, there are increasing calls for governments to shield citizens from the burden. The French government has announced that it will reduce gasoline tax by EUR 0.15 per liter for four months starting in April. In Germany, there is criticism that the government is earning money from the increase in the price of gasoline via VAT. The claim is that the additional revenue should be returned to the citizens. Some are calling for fuels to be subject only to the reduced VAT rate of 7 percent. Since VAT rates cannot be changed at will due to European law, German Finance Minister Christian Lindner wants to introduce a gasoline rebate – people should submit fuel bills to the tax office and get a portion refunded.

That is well-intentioned. Politicians want to signal that they take their constituents' concerns seriously and are responding to them. Nevertheless, general gasoline price cuts are the wrong way to go.

Symbolic Act or Real Relief?

What amounts are involved? In 2021, the average price of premium gasoline was EUR 1.58, while diesel cost EUR 1.40. The VAT levied on fuel expenditure by private households amounted to an estimated EUR 10 billion. Assuming that premium gasoline and diesel cost EUR 2.20 per liter in 2022, and assuming constant consumption for simplicity's sake, VAT revenue will rise to some EUR 14.5 billion in 2022. The additional tax revenue would therefore amount to a maximum of EUR 4.5 billion. In fact, it would be less, because consumption would fall. However, a reduction in VAT to 7 percent would cost the treasury just under EUR 9 billion. If one really wanted to refund only the EUR 4.5 billion in additional revenue compared to last year, a tax waiver or rebate would be appropriate, corresponding to a good 5 VAT points. A liter of gasoline would then still cost EUR 2.10 instead of EUR 2.20, and even then only if producers passed the tax cut on to consumers in full. This is too little to provide noticeable relief for households that have been hit particularly hard, and still costs the government a lot of money. One could limit the tax cut to four months, as in France, in order to reduce the fiscal cost. But the relief effect would be correspondingly smaller – the whole thing would be more of a symbolic act. In any case, it is questionable to base any relief on the additional revenue from VAT, because higher spending on gasoline leads to lower spending on other goods. The claim that the government would earn money from the price increases is therefore far-fetched.

Relief Means Higher Debt

Regardless of the amount of relief, however, very fundamental arguments speak against general gasoline tax cuts or rebates. Politicians cannot really shield the German population from the

burdens of higher energy prices. If the government lowers gasoline taxes, private households will first spend less on gasoline. But this does not create any real relief, rather an illusion of relief. In return, the state would first incur more debt. These debts will have to be serviced in the future, through taxes paid by precisely those households that are now supposedly being relieved. The fact that the government leaves the money with citizens at first, only to recover it later through higher taxes or spending cuts, is ultimately more expensive than accepting that private households will spend more on gasoline today. Of course, one could argue that the tax cut will ensure greater spending discipline in the future. But there will probably be no lack of pressure on the public finances, and a different, more targeted use of funds would have the same effect in this respect.

More Targeted Redistribution Measures

The government cannot eliminate the burdens of rising energy prices, it can only redistribute them. This can make sense, since not all households are equally able to bear higher gasoline costs. The government can, for example, specifically help low-income households or long-distance commuters. If the government is seen as having an insurance function, it is justifiable to help those who are more burdened than others or are particularly unable to bear higher prices. However, this means that the other households bear not only higher energy costs themselves but also the cost of helping others. The heating cost subsidy for housing benefit recipients, which has already been approved, is an example of targeted assistance. For travel costs, targeted assistance is more difficult, but possible. The long-distance commuter allowance could be increased or, to make the relief independent of the marginal tax rate, it could be supplemented by a tax credit that is granted, for example, from the 20th kilometer. Companies are also affected very differently by rising energy costs, but here, too, targeted assistance is better than across the board relief. It is foreseeable that public budgets will still be significantly burdened in the course of this crisis. This makes it all the more important to ensure that support measures strike a sensible balance between fiscal costs and benefits.

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