

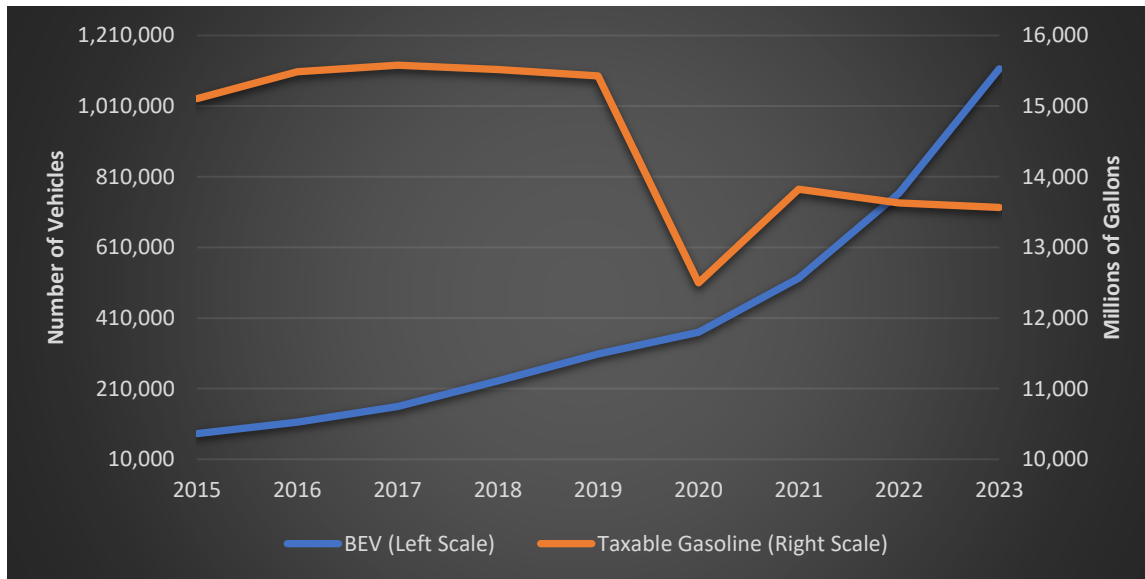


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## The Billion Dollar Fiscal Cliff Behind California's 2035 EV Mandate

In 2020, California Governor Gavin Newsom announced a new plan to ban the sale of new gasoline-powered vehicles by 2035.<sup>1</sup> Californians responded enthusiastically, tripling their purchase of electric vehicles (EVs) in the three years following the announcement.<sup>2</sup> By the end of 2023, over 1.1 million battery electric vehicles (BEVs) were on California roads,<sup>3</sup> while the state's taxable gasoline consumption dropped by 1.8 billion gallons<sup>4</sup>. See Figure 1.

Figure 1: Number of BEV and Taxable Gasoline Gallons, 2015-2023



<sup>1</sup> "Governor Newsom Announces California Will Phase Out Gasoline-Powered Cars & Drastically Reduce Demand for Fossil Fuel in California's Fight Against Climate Change." *Office of Governor Gavin Newsom* (Sept. 23, 2020). <<https://www.gov.ca.gov/2020/09/23/governor-newsom-announces-california-will-phase-out-gasoline-powered-cars-drastically-reduce-demand-for-fossil-fuel-in-californias-fight-against-climate-change>> (accessed Aug. 14, 2024).

<sup>2</sup> "Annual Electric Vehicle Sales in California." *Veloz*. <[https://www.veloz.org/wp-content/uploads/2024/08/Q2-2024\\_Annual-EV-Sales-in-CA-1-1.png](https://www.veloz.org/wp-content/uploads/2024/08/Q2-2024_Annual-EV-Sales-in-CA-1-1.png)> (accessed Aug. 14, 2024).

<sup>3</sup> "Motor Vehicle Fuel 10 Year Reports." *California Department of Tax and Fee Administration*. <<https://www.cdtfa.ca.gov/taxes-and-fees/spftrpts.htm>> (accessed Aug. 13, 2024).

<sup>4</sup> "ZEV and Infrastructure Stats Data." *California Energy Commission*. <<https://www.energy.ca.gov/files/zev-and-infrastructure-stats-data>> (accessed Aug. 13, 2024).

While this shift marks a significant victory for environmental goals, it presents a looming fiscal challenge. California currently collects approximately 60 cents in excise tax for every gallon of gasoline sold,<sup>5</sup> contributing an estimated \$8.2 billion<sup>6</sup> to the state's \$208 billion<sup>7</sup> budget for the 2023-2024 fiscal year. With fewer gasoline-powered cars on the road, the state faces a future of dwindling fuel tax revenues.

To date, California has managed to offset the decline in gasoline consumption by incrementally raising the excise tax, from 47.4 cents three years ago to the current 59.6 cents per gallon. This has kept revenue losses marginal, from \$8.5 billion<sup>8</sup> to \$8.2 billion. However, Californians already pay the highest gas taxes in the nation,<sup>9</sup> and further rate hikes could face significant public and political resistance. As electric vehicle adoption accelerates, the resulting decline in fuel tax revenue could create a substantial fiscal gap, threatening the funding of critical infrastructure projects such as road maintenance and highway expansions, which rely heavily on these funds.

To illustrate the potential long-term fiscal impact, consider a scenario where 50 percent of all cars in California are electric by 2035. Assuming a steady annual increase in the number of EVs and no significant change in the total vehicle population, we can project the number of electric and non-electric vehicles each year. Using the average taxable gasoline consumption per non-electric car from 2021-2023 as a baseline, we can estimate the annual taxable gasoline gallons over time.

**Figure 2** reveals a stark reality: if the excise tax rate remains constant at 59.6 cents per gallon, fuel tax revenue could be halved by 2035, resulting in a cumulative revenue loss of \$26 billion. To counterbalance this loss through tax increases alone, the gas tax would need to rise to a staggering \$1.15 per gallon by 2035. Such an increase would likely be untenable for many residents, especially those in lower-income brackets, who are already burdened by the high cost of living in California.

To mitigate this potential shortfall, policymakers may have to explore alternative revenue sources. One approach is to levy additional taxes or fees on electric vehicles, which are currently exempt from fuel taxes. For example, California imposes an annual \$108 registration fee on EVs.<sup>10</sup> Another proposal gaining traction is the introduction of a per-mile fee for electric vehicles, a system

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<sup>5</sup> "Sales Tax Rates for Fuels." *California Department of Tax and Fee Administration*. <<https://www.cdtfa.ca.gov/taxes-and-fees/sales-tax-rates-for-fuels.htm>> (accessed Aug. 19, 2024).

<sup>6</sup> "Fiscal Year 2023-24 California Transportation Financing Package." *California Department of Transportation* (Apr. 17, 2024). <[https://dot.ca.gov/-/media/dot-media/programs/budgets/documents/fiscal\\_year\\_2023-24\\_california\\_transportation\\_financing\\_package\\_signed-a11y.pdf](https://dot.ca.gov/-/media/dot-media/programs/budgets/documents/fiscal_year_2023-24_california_transportation_financing_package_signed-a11y.pdf)> (accessed Aug. 14, 2024).

<sup>7</sup> "The 2023-2024 California State Budget Explained." *California Budget & Policy Center*. <<https://calbudgetcenter.org/resources/state-budget-explained-california/>> (accessed Aug. 14, 2024).

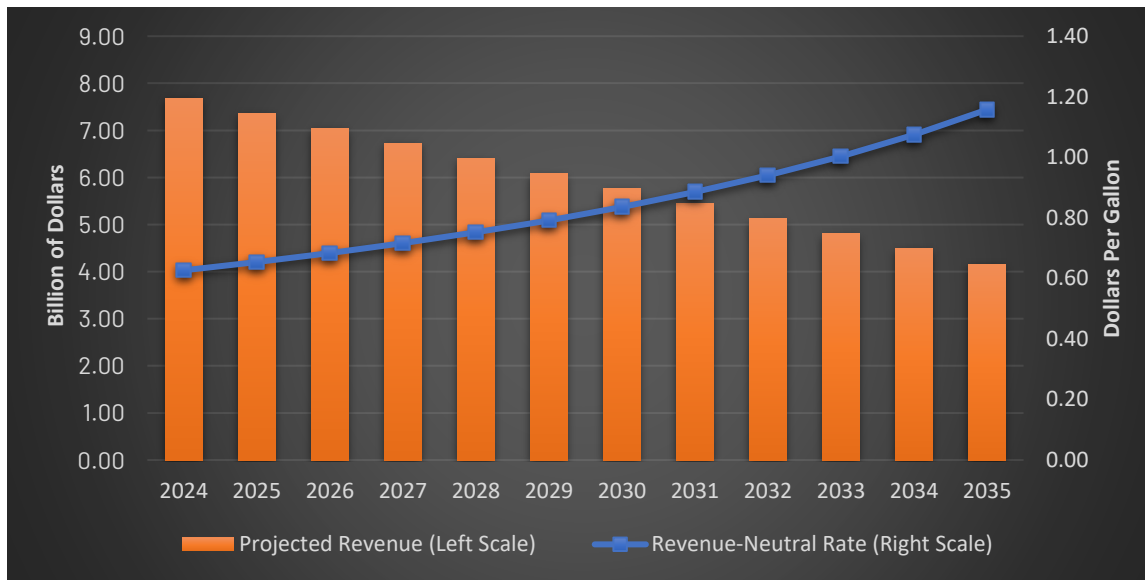
<sup>8</sup> "Transportation Funding in California 2019." *Caltrans*. <[https://gettingaroundsac.blog/wp-content/uploads/2020/07/caltrans\\_transportationfundingbooklet\\_2019.pdf](https://gettingaroundsac.blog/wp-content/uploads/2020/07/caltrans_transportationfundingbooklet_2019.pdf)> (accessed Aug. 14, 2024).

<sup>9</sup> "Gas Tax Rates by State, 2024." *Tax Foundation*. <<https://taxfoundation.org/data/all/state/state-gas-tax-rates-2024>> (accessed Aug. 15, 2024).

<sup>10</sup> Jaros, Benjamin and Adam Hoffer. "How Are Electric Vehicles Taxed in Your State?" *Tax Foundation*. <<https://taxfoundation.org/data/all/state/electric-vehicles-ev-taxes-state>> (accessed Aug. 13, 2024).

already under consideration in states like Minnesota.<sup>11</sup> This could ensure that EV owners contribute to the maintenance of the roads they use, aligning with the “user pays” principle that underpins current fuel taxes.<sup>12</sup> However, these measures would need to be carefully calibrated to avoid discouraging the adoption of electric vehicles, which remains a key component of the state’s climate strategy.

**Figure 2: Projected Fuel Tax Revenue and Revenue-Neutral Tax Rate**



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<sup>11</sup> Alex Nieves. “The Dark Side of the EV Revolution: Road Taxes.” *Politico* (Agu. 14, 2024). <<https://www.politico.com/news/2024/08/14/ev-gas-tax-drivers-california-00173619>> (accessed Aug. 14, 2024).

<sup>12</sup> Pomerleau, Kyle. “Replacing the Gas Tax with a Mileage-Based Tax.” *Tax Foundation* (Feb. 25, 2015). <<https://taxfoundation.org/blog/replacing-gas-tax-mileage-based-tax/>> (accessed Aug. 19, 2024).