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INSIDE

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For states, no clear path on transportation

Proposed gas-tax hikes this year reflect ongoing struggle to fix infrastructure — and funding shortfalls

by Laura Kliewer (lkliewer@csg.org)

In Michigan, lawmakers say an additional $1.4 billion a year is needed for the state's roads and bridges.

An Iowa study released in late 2011 found that the state needed to generate $215 million more annually "to meet the state's critical roadway needs."

The two states are not alone. Across the Midwest, and the country, states have studies detailing shortfalls in transportation funding and the need for greater infrastructure investment. Nationally, the latest report from the American Society of Civil Engineers estimates that a $2.2 trillion, five-year investment is needed to bring the condition of the nation's infrastructure up to a good standard. Only half of that amount is currently being spent.

But where will the additional money come from?

At this point, states likely aren't holding out hope for an influx of additional revenue from the federal government, which, according to the National Association of State Budget Officers, accounts for close to one-third of states' total transportation spending.

The federal gas tax has remained unchanged since 1993, and federal surface transportation reauthorization has repeatedly stalled.

"On the federal side, things have been essentially stagnant at best and extremely uncertain at worst," says Joung Lee, deputy director of the American Association for State Highway and Transportation Officials' Center for Excellence in Project Finance.

States, meanwhile, face continuing fiscal constraints and political pressures of their own.

Motor-fuel excise taxes have long been the primary means for state-funded transportation investment, along with other dedicated revenue sources such as tolls, motor vehicle taxes and vehicle registration fees. (No state in the Midwest relies much on general fund revenue to fund its roads; Indiana, Iowa, Michigan, Nebraska and Wisconsin report using no such revenue at all.)

For a variety of reasons — more fuel-efficient vehicles on the road and stagnant gas-tax rates not keeping up with inflation, for example — these state-level revenue sources are not raising enough money to meet infrastructure needs.

The result in recent years has been a host of legislative actions and proposals: for example, raising the gas tax in Minnesota; dedicating more sales tax revenue to roads in Kansas and Nebraska; and encouraging public-private financing of transportation projects in Illinois, Indiana and Ohio.

State motor fuel taxes in Midwest, cents per gallon (as of Jan. 1)

State	Gasoline		Diesel	
	Excise tax	Total state taxes/fees*	Excise tax	Total state taxes/fees*
Illinois	19.0	38.9 cents	21.5	43.7 cents
Indiana	18.0	38.9 cents	16.0	49.0 cents
Iowa	21.0	22.0 cents	22.5	23.5 cents
Kansas	24.0	25.0 cents	26.0	27.0 cents
Michigan	19.0	39.4 cents	15.0	37.9 cents
Minnesota	28.0	28.1 cents	27.5	27.6 cents
Nebraska	26.7	27.6 cents	26.7	27.0 cents
North Dakota	23.0	23.0 cents	23.0	23.0 cents
Ohio	28.0	28.0 cents	28.0	28.0 cents
South Dakota	22.0	24.0 cents	22.0	24.0 cents
Wisconsin	30.9	32.9 cents	30.9	32.9 cents

** Includes sales tax on motor fuel purchases (Illinois, Indiana and Michigan); fees for underground storage tank fees (Illinois, Iowa, Nebraska and Wisconsin); environmental fees (Kansas and Michigan); and inspection fees (Indiana, Minnesota and South Dakota).*

Source: American Petroleum Institute

'Unfixing' the gas tax to keep up with road costs

In December, the nonpartisan Institute on Taxation and Economic Policy published a report detailing why the gas tax is one of state government's "least sustainable revenue sources."

The root problem with the tax, authors of the study say, is that it is fixed. In the Midwest, for example, only Nebraska incorporates a variable rate based on the price of motor fuel. (That state's motor fuel tax is a mix of a fixed tax, 10.3 cents per

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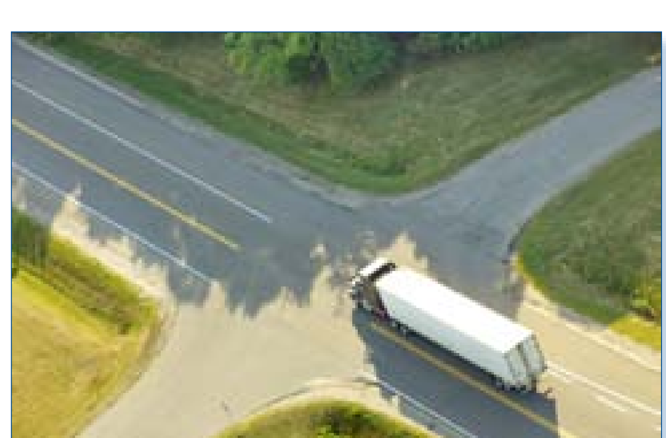


Many states are at a crossroads when it comes to transportation funding. They must find ways of making traditional revenue sources such as the motor-fuels tax more sustainable or explore alternative financing options.

CONTINUED FROM PAGE 1

Kansas, Nebraska among states boosting transportation investment via sales taxes

gallon; a wholesale tax, 12.3 cents; and a variable tax, 4.1 cents.)

For every other state in the region, the gas tax rate remains constant minus legislative action.

As a result, authors of the institute report say, "State gas taxes have fallen dramatically relative to the rising cost of asphalt, concrete, labor and everything else that goes into maintaining a transportation network."

They propose a three-fold solution to the sustainability problem: increase gas tax rates, make future increases automatic (based on inflation or gas prices), and target tax credits for low-income families to offset the impact of these changes.

Proposals to raise the gas tax are, in fact, not uncommon. However, very few of these measures have gotten through state legislatures in recent years.

Entering the 2012 legislative year, Minnesota was the last state to approve an increase in the gas tax. Its tax hike was approved in 2008, in the aftermath of the deadly collapse of an interstate highway bridge. Under the bill (HF 2800), through a series of phased-in increases over four years, the state's gas tax will eventually be increased by 8.5 cents, to a total of 28.5 cents per gallon. (Part of the increase is going to pay off state bonds.)

That puts Minnesota on the higher end of state gas-tax rates in the Midwest, which range from a low of 18.0 cents in Indiana to a high of 30.9 cents in Wisconsin. (Most states in the region also collect other state taxes and/or fees on gasoline and diesel; see the chart on page 1 for details.)

This year, Michigan, Iowa and Illinois are among the states where increases in the motor fuel tax are under consideration.

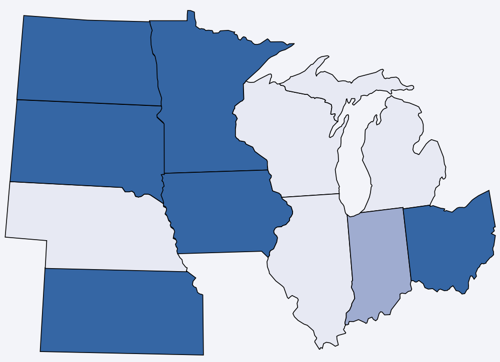
In Michigan, addressing the state's $1.4 billion shortfall in transportation funding has become a priority of Republican Gov. Rick Snyder, who noted in a speech last fall that "for the first time ever, transportation revenues are declining."

"Simply put, better fuel economy and higher gas prices lead to lower road revenues from the fixed fuel tax," he said.

Several ideas have been proposed to reverse that trend and close the funding: for example, increasing the state's vehicle registration tax by approximately 67 percent (HB 5300 and SB 919) and replacing Michigan's fixed tax on motor fuels (HB 5298, HB 5299 and SB 918).

The state currently has two separate fixed rates

State laws on use of fuel-tax revenues



Constitutional requirement that fuel-tax revenues be used for highway and road purposes only

Statutory requirement that fuel-tax revenues be used for highway and road purposes only

Broader transportation objectives can be funded*

* The Michigan Constitution requires motor-fuel and vehicle-registration taxes to be used for transportation purposes, 90% of which must be used for roads, streets and bridges.

Source: "Transportation Governance and Finance," a joint project of the National Conference of State Legislatures and the AASHTO Center for Excellence in Project Finance

for gasoline (19 cents per gallon) and diesel (15 cents). In their place would be a new tax based on the wholesale price of unleaded regular gasoline, with the rate set at 10.1 percent. This new variable tax would be adjusted quarterly, with controls in place in the case of wild price fluctuations. In addition, the new variable tax rate could never exceed the equivalent of a tax rate of 40 cents per gallon.

Michigan last increased its gas tax in 1997.

In Iowa, it has been 23 years since the rate was raised, but that would change under bills that, as of early March, were moving through the Democrat-controlled Senate and Republican-led House.

These measures are in part a response to a state study released in late 2011 detailing the need for at least $215 million a year in additional transportation revenue.

"The critical needs of our streets and roads remain and will not go away but merely become more acute if we do nothing again this year," says Iowa Republican Rep. David A. Tjepkes, chair of the House Transportation Committee.

"Cities and counties are currently being forced to use other financing means to meet some of their needs."

Tjepkes says the House and Senate measures would raise the equivalent of a 10-cent increase in the gas tax.

The Senate measure (SF 2224) would do so by increasing the tax by 10 cents over the next two years. In contrast, the House measure (HSB 547) delays the tax increase by one year and would only raise it by 8 cents. It makes up the difference by raising vehicle registration fees on new-vehicle purchases, and by adding new fees for the owners of hybrid and alternative-fuel vehicles.

The tax and fee increases, Tjepkes says, are consistent with the recommendations of a governor's commission that studied the state's transportation funding needs in 2011.

He says the measures, like any proposed tax increase, have faced an uphill battle in the legislature. But Tjepkes notes that a significant portion of the tax increase would be paid by out-of-state drivers, who account for an estimated 20 percent of the miles driven on Iowa roads.

In neighboring Illinois, a different type of gas-tax increase is being considered in 2012. Proponents of SB 3236 want to raise the tax in the Chicago area alone and dedicate the additional dollars to improving public transit in that part of the state. The same measure would also index the motor fuel tax, in the Chicago area, to inflation.

New sales pitch: Redirect sales taxes to bolster transportation funding

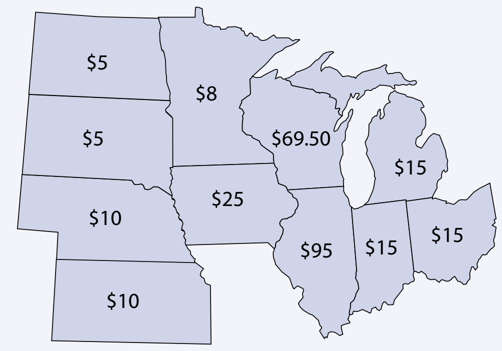
In most states, a sales tax is not levied on purchases of diesel or gasoline — with the three exceptions being Illinois, Indiana and Michigan. And in these three states, the sales tax on motor fuel is not dedicated solely to transportation purposes.

Legislation currently pending in Michigan (HB 4521) would change that: It calls on revenue from the sales tax on motor fuels to be redirected from the general fund for transportation purposes. (Constitutional requirements would still direct some of the revenue to still go toward local governments and schools.)

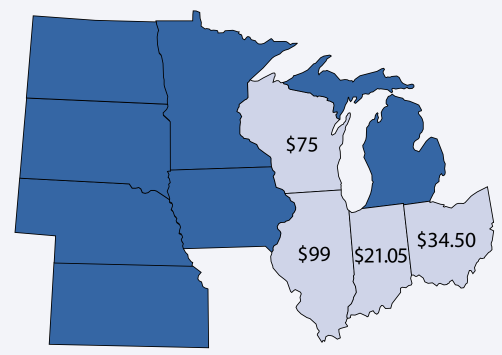
This idea of dedicating more sales tax dollars to transportation has already caught on in three other Midwestern states. In Kansas, Nebraska and Wisconsin, the legislatures have passed bills in recent

Vehicle title, registration fees in Midwest

Title fees



Registration fees



Flat fee

Fee varies based on car's value, age and/or weight

Iowa — Fees for vehicles up to 11 years old are 40 cents per 100 pounds, plus a percentage of the vehicle's value: for vehicles up to 7 years old, 1% of the list price; for vehicles 8-9 years old, 0.75% of the list price; for vehicles 10-11 years old, 0.5% of the list price. For vehicles more than 12 years old, fee is $50.00.

Michigan — Fee depends on vehicle's value. For cars worth between $0 and $30,000, fee is between $30 and $148. (Owners of cars valued at more than $30,000 pay more.) These fees are for the first year of registering the vehicle; they are then reduced by 10 percent in each of the next three years.

Nebraska — Base vehicle registration fee is as follows: $5 for cars valued at $20,000 or less when new; $20 for cars valued at between $20,000 and $39,000 when new; and $30 for cars valued at more than $40,000. An additional fee is then added and varies depending on vehicle's age.

North Dakota — Fees range between $49 and $274, based on weight of vehicle and number of times it has been registered.

South Dakota — Fees vary depending on weight of vehicle: $30, vehicles under 2,000 pounds; $51, vehicles between 2,001 and 4,000 pounds; $72.50, vehicles between 4,001 and 6,000 pounds; and $92.50, vehicles more than 6,000 pounds. Fee is reduced by 30 percent for vehicles at least 10 years old.

Sources: AAA "Digest of Motor Rules" and CSG Midwest research

years to redirect general sales-tax revenue to highway projects and other state infrastructure needs.

Kansas' actions were taken two years ago, when the Legislature approved a 10-year, $8 billion transportation program (T-Works) and adopted a temporary 1-cent increase in the state sales tax, thus bringing the rate to 6.3 cents per dollar. In 2013, the rate is scheduled to fall back to 5.7 cents per dollar, and four-tenths of each cent will go toward T-Works — which funds a variety of state transportation projects, including roads, transit, aviation and freight rail.

In January, Republican Gov. Sam Brownback and a bipartisan group of state legislative leaders announced they were accelerating nearly $50 million in road projects in order to take advantage of low construction prices and to spur job growth. But that plan, as well as some of the additional funding from the sales tax for T-Works that begins in 2013, may be in jeopardy. In February, leadership in the Kansas House proposed diverting $351 million in order to replace revenue lost by a proposed reduction in state income taxes.

Starting in 2013, Nebraska will begin collecting a 0.25 percent sales tax for roads as a result of the Build Nebraska Act (LB 84), which was passed last year. The state's overall sales tax rate of 5.5 percent will remain unchanged, but instead of all proceeds going to the general fund, some will be dedicated to two highway funds.

A bill (LB 1098) to repeal provisions of the Build Nebraska Act was introduced this year, due to concerns by opponents that the diversion of sales-tax revenue from the general fund will mean less money for other state priorities.

Starting in 2013, as a result of changes made last year in the state's biennial budget, 0.25 percent of money in Wisconsin's general fund will be transferred annually to the Transportation Fund. That fund, financed primarily from the state's gas tax, vehicle registration fees and federal aid, is used to maintain and upgrade all transportation modes in the state.

There currently are no constitutional requirements that the fund be used solely for transportation purposes. However, a constitutional amendment (SJR 23) to include such a requirement was passed last year in Wisconsin with bipartisan support. It must pass again during the next biennium before being put on the ballot for voter approval.

Rise of P3s: States explore expanded use of public-private partnerships

Tapping into sales taxes is one example of states looking for nontraditional methods of financing their transportation systems.

But some states in the Midwest are also going a step further — looking to new partnerships with the private sector.

Indiana pioneered this approach with Major Moves, a 10-year, $10 billion transportation plan that the state helped finance through a long-term lease of the Indiana Toll Road. The legislature approved plans for the long-term lease in 2006. And last year, lawmakers passed SB 473, which authorizes public-private partnerships, or P3s, for new or expanded transportation infrastructure projects in Indiana.

Two other Midwestern states also passed bills in 2011 expanding the authority of their departments of transportation to enter into public-private partnerships: Illinois HB 1091 and Ohio HB 114.

Lee says P3s and other innovative financing approaches don't necessarily fix a state's transportation funding problems. If the state's traditional user fees aren't enough to meet infrastructure needs, Lee says, that imbalance needs to be addressed — with or without new financing mechanisms in place. However, innovative financing can extend the reach of a transportation plan, so long as a state is willing to live with what comes along with it.

"You are going to be relinquishing some of the controls you have on your facilities or toll-revenue streams," Lee says. "And there are a lot of other potential political issues and factors that come into play, requiring some institutional knowledge in knowing that what you're getting into is very complex and time-consuming."

> "The critical needs of our streets and roads remain and will not go away but merely become more acute if we do nothing again this year."
>
> Iowa Rep. David Tjepkes

State revenue sources used for roads, bridges, rail and transit

Revenue source	Midwest states using this source
Fuel taxes	All (Iowa and Nebraska use a variable or indexed tax rate)
Sales tax on motor fuel	Illinois, Indiana and Michigan
Motor vehicle or car rental sales taxes/fees	Iowa, Minnesota, Nebraska, North Dakota, South Dakota and Wisconsin
Vehicle registration, license or title fees	All
Vehicle or truck weight fees	Illinois, Kansas, Minnesota, North Dakota, Ohio, South Dakota and Wisconsin
Traffic camera fees	Illinois, Iowa (used only at local level) and Ohio
Tolls	Illinois, Indiana, Kansas, Michigan and Ohio
General funds	Illinois, Kansas, Minnesota, North Dakota, Ohio, South Dakota and Wisconsin
Interest income	Illinois, Iowa, Minnesota, Nebraska, North Dakota, Ohio, South Dakota and Wisconsin

Source: "Transportation Governance and Finance," a joint project of the National Conference of State Legislatures and the AASHTO Center for Excellence in Project Finance