Down the funding road again: In states such as Iowa, Michigan and South Dakota, legislators appear closer to finding solutions to transportation shortfalls

Tim Anderson

As the new legislative year begins, a years-old problem will once again be on the minds and agendas of lawmakers in several of the Midwest’s capitols: How can we raise more revenue for our ailing roads and bridges, and close shortfalls in our highway funds?

Early signs point to a busy, and potentially productive, few months ahead. Governors in states such as Iowa, Michigan and South Dakota are backing some kind of revenue fix, business groups continue to support it, and legislatures have a host of policy alternatives to consider.

On top of those factors, gas costs have been falling for consumers, which could make a legislated increase in the gas tax more politically and economically palatable.

“I think the chances are very high that something gets done,” says Iowa Sen. Tod Bowman, chair of the Iowa Senate Transportation Committee.

His state’s current annual funding shortfall stands at $215 million, and that’s just to address “critical” road and bridge needs. In a “pay as you go” state such as Iowa, closing this gap inevitably means some mix of higher taxes and fees.

“The most important part of getting this done is being able to explain the need,” Bowman says. “Explain why this is imperative to the state of Iowa. That trumps everything else.”

The support of Gov. Terry Branstad will be a big help in making the case, he adds. Similarly, Sen. Mike Vehle and other legislative proponents in South Dakota were heartened by the budget address given by their state’s governor.

“This is a year that we need to act to adequately fund our roads,” Gov. Dennis Daugaard told lawmakers.

The Michigan Legislature, meanwhile, got a head start on the new year by passing a new transportation plan in late 2014. Its package provides an additional $1.2 billion a year for roads and bridges through a mix of revenue enhancers, including a 1-cent increase in Michigan’s general sales tax. But the plan was passed as a ballot proposal, not as legislation. As a result, voters will have the final say on the transportation package in May.

Between then and now, Bowman and Vehle are hoping their state legislatures will have passed bills of their own. In South Dakota, a two-thirds vote in the Legislature will be required (due to language in the state Constitution on tax increases).

“We know how hard it is to keep coming back to this issue, year after year,” Vehle says. “We haven’t done anything [with a gas-tax increase] since 1999, and the feds haven’t done anything since 1993. It’s tough to do. “So let’s focus on passing something that not only works now, but works in the future.”

With that in mind, a plan proposed by an interim legislative committee led by Vehle seeks longer-term fixes, in part by adding some new sources of revenue for roads. One of those new sources would be a wholesale sales tax on gasoline. Historically, South Dakota has relied on a cent-per-gallon tax to fund its state roads, with license-plate fees and property taxes used for local roads.

Adding the wholesale tax to the mix, Vehle says, would allow state revenues to keep better pace with road-construction costs.

Wholesale vs. per-gallon taxes
An increasing number of state legislatures are considering adoption of some kind of wholesale sales tax. It is already part of the road-funding formula in Nebraska, and in Michigan, the ballot proposal would replace the state’s per-gallon tax with one based on 14.9 percent of the average wholesale prices of gasoline and diesel.

One of the benefits of a wholesale tax is that state revenue would rise when gasoline and diesel prices increase. In contrast, minus legislative action, states’ per-gallon gas taxes don’t change. (Very few states tie their per-gallon tax to changes in inflation.) The per-gallon tax is also becoming a less-dependable revenue source because fewer miles are being driven, and in cars that are more fuel-efficient.

“It’s not producing the revenue that it did 10, 20 or 30 years ago,” says Richard Auxier of the State & Local Finance Initiative, a program of the Urban Institute and Tax Policy Center.

In a November 2014 study, Auxier documents the demise of the per-gallon gas tax. On a per-capita basis, U.S. state and local motor fuel taxes fell 10 percent from 1993 to 2011 (adjusted for inflation); in comparison, total state and local tax revenue increased 21 percent over that same time period.

And as a percentage of the price of gasoline, state and federal taxes have fallen from 28 percent of the total (in 2000) to 12 percent (in 2013). That leaves legislators with one of three options, Auxier says: raise motor fuel taxes, tap into other revenue sources (tolls and sales taxes, for example), or don’t fully address their state’s road and bridge needs.

The wholesale tax, then, is one way to either raise more revenue immediately, or to at least allow road funding to increase over time. Bowman says such a tax will receive serious consideration in Iowa this year, but he notes that there are potential downsides. Over the past year, for example, the price of gas has dropped, meaning state revenues for roads would have fallen with a lower wholesale price. On the flip side, dramatic increases in the price could lead to sticker shock at the pump.

“We would need some type of floor [to prevent these fluctuations],” Bowman says.

The Michigan proposal includes such a provision. For example, it would not allow the new levy to increase by more than 5 cents per gallon above the rate of inflation. It also protects against revenue declines due to falling wholesale gas prices.

In addition to adding a wholesale tax, South Dakota’s initial legislative proposal still counts on the state’s traditional revenue source for roads. Starting in 2017, for example, the per-gallon gas tax would increase by 2.5 percent annually over a 10-year period.

To provide more funding for South Dakota’s local roads, license plate fees would be increased by 10 percent. In addition, the interim committee’s draft legislation calls for a new 7-cent tax on dyed diesel fuel (used in farm and construction equipment).

Those local roads are essential to the state’s No. 1 industry: agriculture.

“If you produced it, a road moved it,” Vehle often says in his speeches to rural audiences.

Local roads and bridges are currently in much worse shape than the state highways, Vehle says. For example, more than a quarter of the county bridges in South Dakota have been deemed structurally deficient; the price tag to fix them is well over $200 million.

To begin addressing this need, the interim committee suggests establishing a bridge fund. To qualify for funding, counties would need to impose a “wheel tax” (most already do) and have a road and bridge plan in place.

In Iowa, other road-funding proposals have included raising the per-gallon gas tax or applying the state’s sales tax to gas purchases. Bowman says he is keeping an open mind to all of these funding alternatives, but with an eye toward finding a permanent solution by the time the legislature adjourns for 2015.

“My hope is we have something that keeps us from having to come back two or three years later and say, ‘We need more.’”
Washington, D.C.

After a slow year in 2014, discussion and action on transportation funding is expected to ramp up this year in state legislatures across the country. Sean Slone, the program manager for transportation policy at The Council of State Governments, has been reporting on the twists and turns in this critical policy area for CSG since 2008.

Below, he answers questions about the year ahead, and explains why state policymakers should brace for more gridlock in the nation’s capital over federal transportation policy.

**Q: What kind of transportation funding problems and shortfalls are we currently seeing at the federal level?**

A: Congress last summer approved an extension of the 2012 surface transportation authorization legislation known as MAP-21 and patched up the depleted federal Highway Trust Fund with $10.8 billion from the general fund and other available funds.

But it was a short-term fix (one of 21 short-term measures over the last several years) that is expected to allow states to reimburse contractors for work on transportation projects only through May (just as the construction season begins in many states).

Beyond that and if nothing is done, the trust fund faces a $160 billion deficit over the next 10 years just to maintain existing programs. The Congressional Budget Office has estimated that a new six-year authorization bill, which was at one time the norm, that keeps spending at FY 2014 levels would cost $330 billion and require at least $100 billion of additional revenue.

**Q: What can states expect from the U.S. Congress with regard to transportation funding?**

A: Despite low gas prices of late, I think it’s unlikely we’ll see Congress approve a gas tax increase. The federal gas tax was last raised in 1993 and has never been adjusted for inflation, which has led to the predicament we’re in with the Highway Trust Fund.

But the chairman of the House Transportation and Infrastructure Committee, Rep. Bill Shuster, recently ruled out a gas tax increase or another kind of user fee to pay for a new authorization bill. Despite some pockets of support in Congress, an increase doesn’t appear to have widespread support. And the Obama administration has never gotten behind a gas tax increase. A more likely scenario that some have mentioned is that a longer-term transportation authorization bill could emerge as part of a larger corporate tax reform deal.

But the chances of a new Congress just getting their sea legs pushing a major package like that through before May also seem slim. So come May, we could see another short-term, temporary extension of indeterminate length to buy time.

The problem is, the further we get into 2015, the politics of the 2016 election starts to play a role and could make a long-term bill even more difficult.

There are also those on Capitol Hill who would like to see the federal government scale back its role in transportation and largely leave up to states the jobs of raising the revenues and deciding what to spend them on. It’s unclear yet whether that approach will gain additional support.

**Q: Looking broadly across the country, how have states fared in trying to address their own funding shortfalls in transportation?**

A: After a couple of years of relatively little activity, 2013 was a busy year for states when it comes to transportation funding. Six states (Virginia, Maryland, Massachusetts, Vermont, Pennsylvania and Wyoming) approved major transportation funding revamps and many others either produced smaller initiatives or tried and were ultimately unsuccessful.

By comparison, 2014 was a quieter year because of elections and a variety of local issues. It should be noted that in many cases, these state activities we have seen aren’t necessarily the result of federal uncertainty or the expectation that the federal transportation program might one day go away entirely.

States have acted expecting they will continue to have a strong federal partner. They have acted because they wanted to address their own backlogs of projects, because they were tired of only being able to pay for debt service
on past projects, because they wanted to take advantage of economic development opportunities to move their states and communities forward or for a variety of other reasons.

**Q:** What have been some of the common state strategies to raise more revenue?

**A:** We’ve seen everything from more or less straight-up gas tax increases to more complex everything-but-the-kitchen-sink approaches involving swapping one tax for another and incorporating a variety of other strategies. To get those passed, it helps to have the governor and legislative leaders become champions for the legislation. It helps to make the benefits known to the public of increased infrastructure investment and to make them aware of the local projects that can be funded in their communities. And it helps to build coalitions of diverse stakeholders who can get behind the effort.

**Q:** What kind of year do you expect in state legislatures?

**A:** If the early indicators are correct, 2015 could see a large number of states take action on transportation funding. You have a number of states that have gone through extensive planning processes over last summer with study committees and special commissions to come up with recommendations for lawmakers to consider this year. You’ve got a number of states that have been in the conversation for the last several years and that now appear poised to move forward in 2015.

**Q:** In some of our Midwestern states, we’ve seen legislatures turn to the sales tax as a way to raise more revenue for transportation. Is this occurring nationwide?

**A:** Sales taxes are certainly a part of the conversation on transportation funding around the country, but especially in the Midwest. A 5 percent sales tax on fuel purchases is one of the things being talked about in Iowa. Gov. Mark Dayton in Minnesota has proposed a wholesale sales tax on gas. Gov. Scott Walker in Wisconsin has suggested a sales tax might be a more stable transportation funding mechanism for his state. On the other hand, Governor-elect Bruce Rauner in Illinois has argued that raising the state sales tax would be regressive and hurt competitiveness.

The package agreed to by the Michigan Legislature, and that will go to the voters this May, involves both increasing the retail sales tax and applying a wholesale percentage tax on gas while eliminating the current fixed sales tax on gas.

There are a variety of ways to employ a sales tax to help fund transportation, and they all have their potential advantages and disadvantages. You can apply a sales tax to gas, you can draw on revenues produced by broad-based retail sales taxes, or you can allow localities to pass local-option sales taxes to fund local projects.

In transitioning to a sales tax, policymakers hope to create a more predictable revenue source that can more accurately reflect inflation and shield them to some degree from the declining revenues due to declines in driving that gas taxes have faced.

The logic of using revenues from a broad-based sales tax is that you can capture some of the folks who don’t drive but still benefit from the transportation system. One of the problems many transportation analysts have with sales taxes is that they are less transparent and less of a true user fee than the per-gallon gas tax. Most Americans already don’t have a good understanding of how much they pay in gas taxes, where that money comes from and where it goes. Sales taxes would seem to make that picture even hazier.

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