[HPS] LEADING THINKING

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Lowering The Gas Tax To Fund Infrastructure

Findings:

- **Inflation has eroded gas tax revenues over time and has resulted in significant shortfalls for infrastructure spending.**
- **If in the 1990s we had cut the gas tax but changed it to a percentage – instead of raising the gas tax – we would have more money for infrastructure today.**

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The views expressed in this document represent those of the authors alone.

THE idea of infrastructure investment has been one of few bipartisan policy areas in recent years, but despite general agreement the issue has stalled out against other priorities. This is due in large part to the nagging question of how to pay for it and the impact any tax would have on families and the economy.

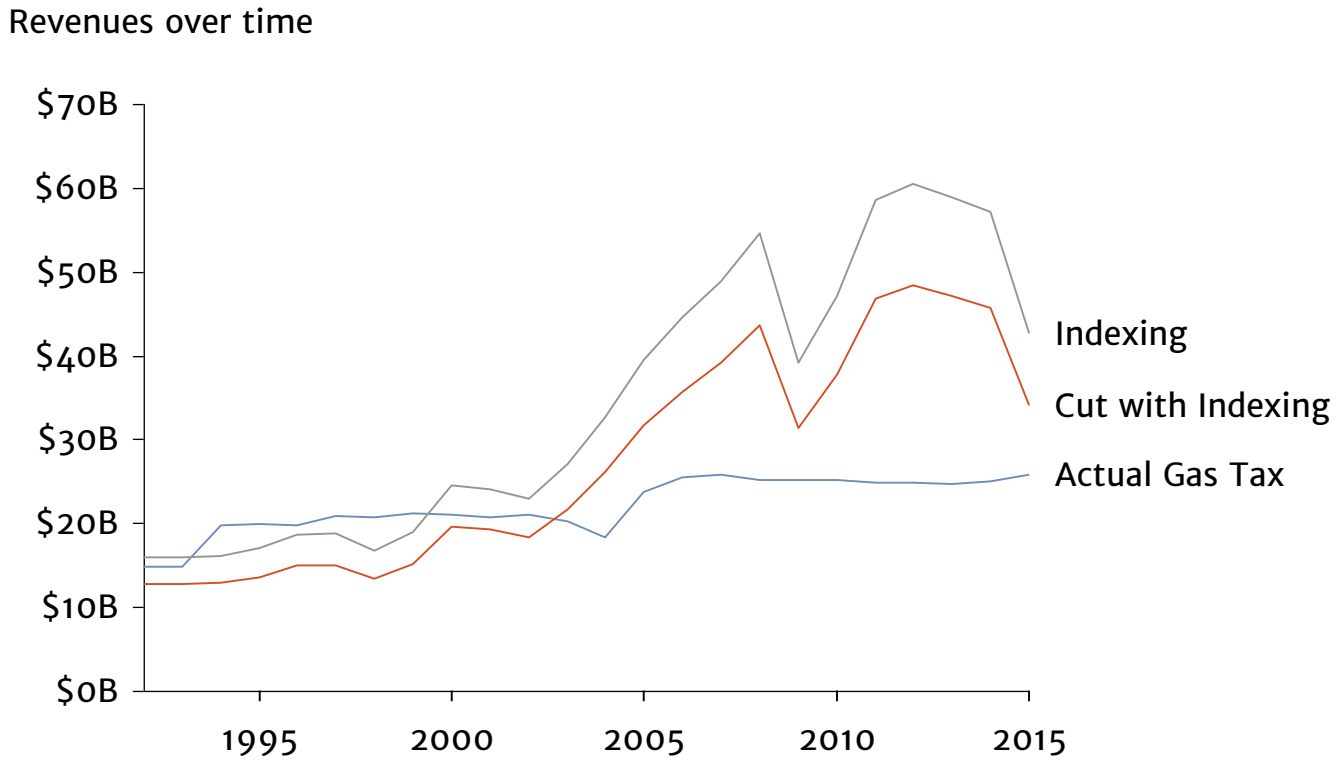
With infrastructure week raising the issue again, it's worth revisiting the economics behind our national infrastructure funding to look at possible ways to break through the debate.

"What if there were a way for Congress and the administration to cut the gas tax while raising more revenue to fund long-term infrastructure needs?"

There are always policy debates where the politics and the economics don't line up perfectly. In the case of infrastructure spending – as with many other issues – people want more of it, and they don't want to pay for it. The Administration has sought to address this political challenge by using an approach of leveraged funding and private-public partnerships. This could make some sense as with any other leveraged approach to have the costs matched against the useful life of the investment. The gas tax makes sense as well since it most directly matches the users of infrastructure to the cost of infrastructure. People who use the roads pay to use the roads. But of course, the gas tax is politically unpopular.

What if there were a way for Congress and the administration to cut the gas tax while raising more revenue to fund long-term infrastructure needs? Such a solution would theoretically solve for both the economic and political dynamics at play.

Figure 1: Congress Could Have Cut The Gas Tax And Still Raised More Money For Infrastructure



Source: Department of Transportation, Department of Energy

Infrastructure funding

Most federal surface transportation projects are funded by an 18.4 cent excise tax on gasoline, and a similar tax on diesel that impacts commercial transportation. The gas tax is a fixed amount, last raised in 1993. Because the gas tax is fixed, inflation in the cost of infrastructure and improvements in vehicle fuel efficiency have both eroded the real revenues raised by the tax.

As a result, surface transportation funding has hit a few inauspicious milestones in the last decade according to the Congressional Research Service. Until 2008, the gas tax fully funded the Highway Trust Fund, which finances most federal surface transportation projects. But since then, the gap between revenues raised and expenditures has grown so large that Congress has had to appropriate some $143 billion from general revenue to shore up the Highway Trust Fund. If nothing is done, the Highway Trust Fund will face another deficit of over $100 billion by 2026.

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Gas tax politics and policy

Conventional political wisdom has stated that the gas tax, which is in effect a direct user fee, is more politically palatable than most taxes, but recent history has shown it to be a political loser. The last two increases in the federal gas tax, 1990 and 1993, were both in part attributed as causes of President George H. W. Bush's failure to win re-election in 1992 and the midterm beating President Clinton took in 1994.

The other serious policy option for raising the gas tax outside of a straight increase is indexing the tax in some

way. While this would be an effective tool – in the past ten years it would have raised nearly twice as much as the current 18.4 cent per gallon tax – it has proven to be as politically unpalatable among policymakers as a straight increase in the tax.

But a proposal to cut the existing level of the federal gas tax while indexing it as a percentage of the price of gas produces a winning scenario not only for members of Congress running for re-election but also for funding the Highway Trust Fund. It would have a stimulating effect on the economy, while at the same time providing assurance of long-term investments in continued growth.

Our analysis shows that if Congress had voted in 1993 to decrease the then-14 cents federal gas tax to 11 cents but also indexed it as a percentage of price, the tax would still be generating more revenue for the Highway Trust Fund than the actual increase enacted at the time. (Fig. 1) In fact, by 2008 – the year when outlays from the trust fund began to exceed gas tax receipts – the cut-and-index scenario would have raised 18 billion dollars more than the enacted increase.

There are, of course, tradeoffs. For the first decade after the theoretical cut-and-index vote, this proposal would have generated less revenue than the enacted increase (to 18.4 cents) did. But starting in 2002-2003, the cut-and-index scenario would have begun raising more money than the historic case. In fact, in several years between 2007 and 2016, the cut-and-index scenario generates nearly twice the revenue for the trust fund as the historic case. When measured over a two-decade timeline (1994-2014), the cut-and-index approach would have raised $124 billion more than the actual tax increase.

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Uncertainties ahead

While this type of tradeoff is what a policy compromise looks like, such an agreement may not lead to a sustainable funding outcome in the long run. Even an indexed gas tax will not result in a sustainable revenue source for roadways if we see radical improvements in efficiency in vehicles or increased adoption of electric vehicles in the medium term.

This challenge points to larger policy disruptions that may be around the corner. With radical innovations in transportation like autonomous vehicles, maglev trains, and shared transportation systems, our infrastructure future may need to look very different than the past. What if our current infrastructure becomes outmoded and must be remade in the coming decades? That scenario would argue for more flexible and forward-thinking investment as a part of the infrastructure debate.

The current infrastructure debate points to a moment when old approaches no longer work and new solutions are not yet apparent. In this context, we need policy to be as creative as the disruption it is designed to address. []