**Statewide Transportation Needs Assessment Revenue Report**

Revenue Generator: **Gas Tax Increase and/or Indexing Tied to Inflation**

Application Federal - State - Regional - Local (circle one)

Introduction

The most common transportation revenue source in the state is the excise tax (gas tax). This is a flat rate tax that is placed on the consumption of each gallon of motor vehicle fuel sold. Currently, the base gas tax in California for gasoline is 18 cents for each gallon sold. Unlike a sales tax, price has no direct impact to the collections from base gas taxes. However, higher gas prices and vehicle fuel economy standards will likely impact the volume of gasoline purchased due to changes in consumer behavior.

Because excise gas taxes have not been increased since 1994, revenues from this source have not been able to keep up with travel demand or inflation. Construction costs continue to rise over time and vehicle fuel economy standards become more stringent, further reducing buying power. In addition to increasing the gas tax, it may be prudent to index the gas tax to inflation (e.g. Consumer Price Index, Construction Cost Index, percentage of the price of fuel, etc.). This would allow revenues to stay consistent with inflationary pressures and increasing construction costs over time.

The revenues generated from an increase in the gas tax could be used for the state highway system and local streets and roads, primarily to fund system preservation, system management, and system expansion.

Yield Potential

Preliminary research indicates that the potential revenue generation from this type of transportation revenue source should be considered as "High". The attached table with projected revenue scenarios and assumptions helps support an increase in gas tax as a high yield revenue generator, but the estimates are rough at best. Caltrans' Division of Budgets, Revenue Forecasting Branch (Branch), estimates that every 1-cent increase in gas tax would generate approximately $147 million annually. However, this does not take into account indexing the gas tax to inflation. Indexed to inflation, this same 1-cent increase would be significantly higher. In order to get a more accurate yield potential, further analysis is warranted.

Use/Restrictions

Based on current revenue distribution, the additional revenue generated from an increase in gas tax would primarily fund system preservation, system management, and system expansion. An increase in gas tax would be a reasonable source to address the specific transportation need because combining the gas tax increase with indexing to inflation would protect existing gas tax revenues from the impacts of inflation, while allowing for additional revenues immediately and long term. The State would receive 65 percent of the tax increase and local cities and counties would receive 35 percent, consistent with the split of the current base excise tax.

Sustainability

An increase in the gas tax should be sustainable over time if it is indexed to inflation. Although, gasoline consumption is declining from year to year, construction costs continue to rise, and vehicles will have to meet higher corporate fuel economy standards. Indexing the gas tax to inflation will mitigate, but not completely alleviate, these issues.

The costs associated with generating additional revenue through an increase in gas tax should be minimal because the current base gas tax system already exists. While there may be additional costs attributable to the planning and implementation of indexing the gas tax to inflation, the gas tax system infrastructure is presently in place. Currently, the California Board of Equalization administers the gas tax statewide, in which the Branch assumes the majority of the cost and effort for administering the gas tax would be absorbed by their department.

Pros/Cons

Pros:

- Collection mechanisms are already in place.
- Potential for significant revenue generation.
- The revenue source is constitutionally protected by Article XIX of the California Constitution.
- Dependent upon the index chosen, it should maintain purchasing power relative to inflation, needs estimates, and construction prices.
- Ease of implementation and inexpensive to administer (utilizes existing practices).

Cons:

- General aversion to tax increases by voters; current political and economic climate may be inopportune for a tax increase.
- Without indexing to inflation, purchasing power of revenues would erode over time.
- Per gallon tax is disproportionate to wear and tear on the state highway system over time.
- Gasoline may be partially or fully replaced by other fuels in the future.
- Motor fuel taxes by themselves are not equitable among vehicle classes (i.e. larger vehicles may pay less in fuel taxes relative to the costs imposed on highways).
- Tax is regressive (older cares pay more).

Furthermore, both the state and local cities and counties would be impacted by the increase in transportation revenue. This is reasonable because without a new revenue source, the condition of the transportation system will continue to deteriorate, affecting Caltrans' ability to improve mobility across California.

Implementation

In comparison to other transportation revenue sources, implementation for an increase in the gas tax should be considered low because the business processes and existing practices are already in place.

The Branch believes implementation can be done on a short term basis (within a two year horizon), but long term adjustments may be necessary. Costs associated with attaining additional information regarding indexing the gas tax to inflation have not been explored. Moving forward, additional research needs to be completed on what type of index should be used for indexing the gas tax to inflation, as well as how much the gas tax should be increased immediately to restore the transportation system to good operating conditions. Furthermore, any policy recommendations are premature at this time.

Conclusion/Recommendation

Costs to preserve the infrastructure that serves transportation needs are soaring, even though construction bids are lower than they have been in years. Ongoing budget shortfalls have forced agencies to defer maintenance, leading to roads and bridges that are in worse shape by the time they are rehabilitated. Investments to preserve transportation systems have not kept pace with the demands on them, and this underfunding has led to the decay of one of California's greatest assets. As the transportation system grows increasingly unreliable, the state will become less attractive to businesses, residents, and tourists, which will ultimately increase our transportation revenue problems.

The next steps include additional research on how much the gas tax should be increased immediately to restore the transportation system to good operating condition, which index should be used for tying it to inflation, and political strategies on how to approach this type of tax increase.

Reference Materials


- Legislative Analyst's Office (LAO), *Funding for Transportation Programs: Issues and Challenges*, April 2008
- Mineta Transportation Institute, San Jose State University, *Transportation Financing Opportunities for the State of California (MTI Report 06-01)*, October 2006
- National Surface Transportation Policy and Revenue Study Commission, *Transportation for Tomorrow*, December 2007
- Caltrans Revenue Forecasting and Financial Analysis Branch, Independent Analysis of Excise Tax Increase, March 2012
- CHCCI: http://www.dot.ca.gov/hq/esc/oe/contract_progress/cost-index-summary.pdf
- CPI: http://data.bls.gov/cgi-bin/surveymost?cu
- 2011 SHOPP: http://www.dot.ca.gov/docs/reports/2011_Ten_%20Year_Shopp_Plan.pdf