

A Higher Road for a Better Tomorrow

MIDWEST ECONOMIC POLICY INSTITUTE

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HB 1002: Investing in Indiana's Future



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INTRODUCTION

The Hoosier State has made significant economic accomplishments in recent years and can boast a strong, thriving economy. Considered the best in the Midwest for businesses, Indiana exemplifies a pro-growth environment with a balanced budget, reduced regulations, and low taxes. The state has the lowest unemployment rate out of its Midwestern neighbors and is lower than the national rate; this is further represented by a record setting level of private sector employment in July 2015 (IEDC, 2017).

Indiana's noteworthy economic accomplishments position it to take bold steps towards improving the state's transportation infrastructure, providing further investment in the network that supports business growth and a thriving economy. Surface transportation infrastructure across the country is in dire need of additional funding to address poor pavement quality, congestion, and safety. The American Society of Civil Engineers assigned the letter grade "D" to the nation's roadways (2017), and Cambridge Systematics estimated for an Indiana Department of Transportation (INDOT) infrastructure funding study that the state's transportation needs range between \$1.5 to \$3.2 billion annually for the next 20 years (2015). The nation on a whole, in addition to Indiana's neighboring Midwestern states, have yet to address these shortfalls; nevertheless, Indiana can act now and be a trailblazer in new transportation funding strategies.

HB 1002: ADDRESSING INFRASTRUCTURE SHORTFALLS

Economic growth is dependent on adequate infrastructure, yet the United States at large is letting infrastructure deteriorate due to insufficient funding (ASCE, 2016). In Indiana alone, over half of all bridges owned by the state are in their last 25 years of life and over 10 percent were declared structurally deficient in 2014 (ACEC, n.d.). Without action, transportation revenues will continue to decline over the following 20 years (Cambridge Systematics, 2015).

The Indiana House of Representatives recently approved HB 1002, which takes the needed steps to address these issues and help maintain Indiana's economic success for years to come by laying out a long-term transportation funding strategy for the state. The notable proposals are summarized below and their corresponding revenues are shown in Figure 1.

Motor (Gasoline) and Special Fuel (Diesel) Taxes and Motor Carrier Surcharge Tax

The motor and special fuel taxes and motor carrier surcharge tax are proposed to be raised by a maximum of \$0.10 starting in July 2017 to \$0.28, \$0.26, and \$0.21, respectively; the rate of the raise is dependent on a formula that takes into account the change in the Consumer Price Index (CPI) and Indiana personal income rates between 2003 and 2016. These rates will be subsequently increased on an annual basis by no more than \$0.01, again dependent on a similar formula, until 2024 (H.R. 1002, 2017).

Vehicle Registration and Electric Vehicle Fees

The rate that standard vehicles pay for annual vehicle registration will increase by \$15 starting in 2018. Additionally, electric vehicles will be subject to an additional annual fee of \$150; this rate will be reevaluated every five years and a new rate will be implemented based on a similar index used for fuel tax increases (H.R. 1002, 2017).

Additional Sales Tax

Currently, the revenues from sales tax collected on fuel is distributed between the motor vehicle highway account (14%) and the general fund (86%). HB 1002 proposes all sales tax

revenue from fuel is distributed to transportation specific funds, including the motor vehicle highway account (14%), the local road and bridge matching grant fund (21%), and the state highway fund (64%) (H.R. 1002, 2017).

Municipal Wheel Tax

As it currently stands, municipalities that have a minimum population of 10,000 can impose an annual wheel tax on registered vehicles in that municipality. The change to this provision now includes municipalities with minimum populations of 5,000 (H.R. 1002, 2017).

Figure 1: HB 1002 Anticipated Revenues, 2021

Anticipated 2021 Revenues	
Motor Fuel Tax	\$383 million
Special Fuel Tax (Diesel)	\$158 million
Motor Carrier Surcharge Tax	\$115 million
Vehicle Registration Fees	\$91 million
Electric Vehicle Fee	\$3 million
Additional Sales Tax	\$361 million
Municipal Wheel Tax	\$9 million
	\$1.119 billion

Source: [APPIAN, 2017](#)

The subsequent sections provide an analysis of the proposed changes in HB 1002 and reflect on potential alternations that will aid Indiana in future years.

FUEL TAXES

Fuel taxes are the principal source of transportation funding throughout the United States and account for 57 percent of the Indiana Department of Transportation’s (INDOT) revenue (Cambridge Systematics, 2015). Motor fuel taxes serve as a transportation user fee, generating revenue from those who directly utilize the transportation system. Accordingly, those who use the infrastructure more, pay more (Craighead & Manzo, 2016). This funding source was suitable in the past to adequately maintain infrastructure; however, because it is a tax per unit, vehicle fuel efficiency and inflation reduce its purchasing power and fuel tax revenues decrease over time (Cambridge Systematics, 2015).

To put it into perspective, if the motor fuel tax in Indiana had been tied to inflation since its last increase in 2003, it would have stood at \$0.23 in 2015 (Manzo, 2015). Moreover, the 2003 rate of \$0.18 per gallon was at a ratio of 11.3 percent of the national average price of a gallon of gas at that time (\$1.59). If that ratio remained constant over time, the state motor fuel tax would be \$0.28 per gallon in 2015 (DOE, 2016).

Therefore, the increases proposed in HB 1002 are not only fitting, but entirely necessary to create sustainable transportation funding in Indiana. As shown in Figure 2, the increased gasoline and diesel fuel taxes put Indiana directly in-line with most of its Midwestern neighbors and the nation as a whole. Indiana would rank 20th and 28th in the nation for gasoline and diesel taxes, respectively, and is only \$0.017 above the national average for gasoline and \$0.013 below for diesel. With the exception of Illinois, Indiana will be within \$0.02 of its neighbors’ gasoline prices and will have lower diesel prices than two of its neighbors. Consequently, due to these negligible price differences, Indiana will not have to fear residents crossing into other states for lower prices.

Figure 2: Midwest Gasoline and Diesel Taxes

State	Gasoline				Diesel			
	Excise	Additional Fee/Tax	Total	National Rank	Excise	Additional Fee/Tax	Total	National Rank
Indiana*	28.0		28.0	20	26.0		26.0	28
Illinois	19.0	1.1	20.1	39	21.5	1.1	22.6	36
Kentucky	24.6	1.4	26.0	25	21.6	1.4	23.0	32
Michigan	26.3		26.3	24	26.3		26.3	27
Ohio	28.0		28.0	20	28.0		28.0	21
National Average	26.3				27.3			

*Reflects proposed changes

Source: [Federation of Tax Administrators](#)

SALES TAX DIVERSION

The redistribution of the sales tax collected on motor fuel will result in a funding shortage in the general fund. HB 1001 proposes this to be rectified by implementing an additional \$1.00 surcharge on a standard pack of cigarettes (2017). As summarized in Figure 3, following the proposed increase, Indiana’s cigarette tax will be comparable to three of its four neighbors. Michigan’s rate will remain above Indiana’s and Illinois’ rate will only be \$0.015 higher than Indiana’s.

Figure 3: Midwest Cigarette Taxes, as of December 31, 2016

State	Excise Tax	National Ranking
Indiana*	1.995	17
Illinois	1.98	18
Kentucky	0.6	42
Michigan	2	16
Ohio	1.6	25
National Average	1.65	

*Reflects proposed changes

Source: [Centers for Disease Control and Prevention](#)

Albeit there is no right or wrong way to resolve the general fund deficit, 70 percent of Hoosier voters support an increase of \$1.50 per pack of cigarettes (Spehler, 2017). Smoking is a leading factor in Indiana ranking 39th in overall health compared to other states and costs Hoosiers \$3.17 billion in lost productivity and \$2.9 billion in health care expenses (Tobacco Free Indiana, 2017). In the end, this increase represents a reasonable tax on a typical Hoosier and keeps the state within reach of the national average.

TOLLING AND PUBLIC-PRIVATE PARTNERSHIPS

In addition to raising revenues from existing transportation funding sources, Indiana must also consider new, innovative sources, like public-private partnerships (P3s). HB 1002 minimally expands upon Indiana’s tolling strategies by directing INDOT to request a waiver from the Federal Highway Administration to allow tolling on interstates, repeals certain restrictions on potential tolling projects, and establishes additional public participation requirements related to tolling (H.R. 1002, 2017). While Indiana is undoubtedly establishing a foundation for tolling as a funding strategy, guidelines related to P3s should be expanded upon; this is particularly relevant as Transportation Secretary Elaine Chao recently specified that the Department of Transportation will be looking

towards innovative funding strategies, including P3s and tolling (Halsey, 2017). It is important to understand how standard tolling compares to P3s, which are briefly described below.

Standard Tolling

Many tolling facilities nationwide are managed and operated by statewide or regional tolling entities that are associated with state governments. The Illinois State Toll Highway Authority (ISTHA) is a prime example. The organization was created by the Illinois General Assembly in 1953 and acts as an administrative agency of the state. It entirely manages and operates its tolling system from user-based tolls and does not receive state or federal funds. Instead, ISTHA authorizes substantial revenue bonds that are backed by anticipated tolling revenues over subsequent years (ISTHA, 2016).

Public-Private Partnerships

Conversely, P3s can leverage private financing to construct public roadways. Similar to the standard tolling method, P3s will typically use tolling as a means to generate revenue. However, instead of the state authorizing bonds and bearing the risk, the risk is transferred to the private entity. Specifically, the private contractor is responsible for cost overruns, construction risks resulting in delays, and operation and maintenance risks (FHWA, 2013). P3s can also offer project acceleration and lifetime construction and managerial efficiencies (Manzo, 2014).

The Trump Administration has expressed the intent to leverage private funding and P3s in revitalizing the nation's infrastructure, and in order for Indiana to take advantage of future federal funding strategies, the state should further pursue P3 legislation. Illinois adopted the Public-Private Partnerships for Transportation Act in 2011, which grants both the Illinois Department of Transportation and ISTHA the authority to develop projects through the P3 process and establishes appropriate guidelines. While Illinois has yet to utilize the act, it can serve as an example for Indiana as it moves towards P3s.

MOVING FORWARD WITH HB 1002

Transportation funding for both the nation and Indiana is currently at a crossroads. New funding must be generated in order to maintain a prosperous economy. As previously mentioned, the Trump Administration and Transportation Secretary Chao both favor private financing and P3s, and Indiana must prepare to take advantage of these potential federal funding strategies. With the following minor alterations, HB 1002 can help lead Indiana to a successful future.

Roll-Back Taxes in the Future

While P3s and tolling are the funding source of the future, it will take years for projects to be constructed and tolling to begin generating revenues. Consequently, fuel tax increases and the sales tax diversion will provide adequate funding in the meantime. The fuel taxes are indexed to appropriately account for inflation and will cease in 2024. While these sunset clauses are already identified for the fuel taxes, the sales tax diversion can also be truncated following an increase in revenues from tolling.

Public-Private Partnerships

Although HB 1002 does little to advance P3s, the state's tolling language can act as a foundation. Language in HB 1002 should be tweaked to promote the creation of P3 regulations and guidelines and specify input from the General Assembly prior to the creation

of tolling facilities, similar to what Illinois developed in 2011. Furthermore, additional language should be added to clarify that current transportation revenue generators, including fuel taxes and sales tax diversions, can cease following adequate revenues from tolling.

In conclusion, transportation funding is on the cusp of a transformation and Indiana is poised to take advantage. The state must act now and strongly consider HB 1002 so that it can take advantage of potential federal funding when it becomes available. It is time for Indiana to step up and be a leader in creating transportation infrastructure investment that will secure the state's future economy.

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