

Commission Briefing Paper 5A-10

Evaluation of Property Taxes, Sales Taxes, and General Revenues as Transportation Revenue Sources

Prepared by: RAND Corporation

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Introduction

This paper is part of a series of briefing papers to be prepared for the National Surface Transportation Policy and Revenue Study Commission authorized in Section 1909 of SAFETEA-LU. The papers are intended to synthesize the state-of-the-practice consensus on the issues that are relevant to the Commission's charge outlined in Section 1909, and will serve as background material in developing the analyses to be presented in the final report of the Commission.

This paper presents information on recent trends in the use of general government revenues, including property, income, and general sales taxes to support the construction and operation of transportation projects and systems. Because general sales taxes that are earmarked for transportation have in recent years been increasing more rapidly than other general government taxes, this paper gives particular attention to the characteristics of those taxes.

Background and Key Findings

The funding of transportation in the United States has long been a partnership among many participants. Before the creation of user fees transportation facilities were largely privately owned, but early government contributions were derived from general revenues. In recent decades, users of the transportation system have provided the lion's share of funding by paying fares for public transit, tolls for some highways and bridges, and other user fees, especially in the form of motor fuel taxes, vehicle registration fees, and heavy vehicle usage fees. In addition, governments at all levels have regularly allocated portions of their general revenues to transportation as well as to competing programs including education, policing, environmental control and many more government activities. Recent reluctance of many state legislatures to raise user fees and willingness by voters to increase general taxes rather than user fees have made general taxes and fees an increasingly important source of transportation revenue in certain locations and contexts even though they have not come close to matching user fees as a source of transportation revenue.

- *General government revenues are far more significant as a source of support for transportation programs and projects at the local level than at the Federal level, while states depend on such taxes and fees to a greater extent than the Federal government but less than local governments.*
- *General government revenues have increased as a source of finance for transportation programs more rapidly in recent years than have user fees.*

- *While voters in the United States are widely characterized as being opposed to tax increases, they have approved a substantial majority of ballot propositions intended to raise revenue for local transportation improvements by levying special sales taxes earmarked for expenditures on local transportation projects and programs.*
- *Increasing reliance on ballot measures to provide transportation funding has been reducing the flexibility of transportation agencies because the ballot measures specify the ways in which the revenues produced must be allocated to particular projects and programs.*
- *General revenues provide an important and useful revenue stream as user fees rise more slowly than transportation costs, but general revenues are far less effective than user fees at inducing efficient use of the transportation system.*
- *Increasing reliance by local governments on specialized transportation taxes such as sales taxes is providing them with more discretion in transportation spending and reducing the role of the states in shaping local transportation spending programs.*
- *General revenues will continue to be an important source of support for transportation systems, especially in the near future and especially at the local level, but are not likely to replace user fees in the medium or long term as the principal Federal source of transportation revenues.*

Introduction

A large variety of general taxes are levied by governments, including income taxes, property taxes, and general sales taxes. General taxes are neither transportation user fees nor specific transportation taxes. Their proceeds are most often placed into the general fund and used to pay for transportation along with many other government expenditures. In addition, many governments also employ “special taxes” that are designated or “earmarked” for transportation programs though they are charged in association with transactions that make it difficult to refer to them as “user fees.” Such taxes include various value capture and development impact fees, sales taxes that are specifically earmarked for transportation expenditures, severance taxes (associated with the removal of resources from the earth), mortgage recording fees, and many more that vary greatly from one jurisdiction to another. Since value capture and development impact fees are the subject of another paper in this series, this paper emphasizes other special taxes, especially sales taxes, which are also increasingly important.

Trends in Transportation Revenues from General and Special Taxes

Cambridge Systematics has estimated that governments at all levels in 2004 raised a total of \$129.5 billion in support of highway programs, of which 64% came from user fees, 24% from general taxes, and 12% from specialized transportation taxes. They also estimated that in that year all governments combined raised another \$38.6 billion for transit programs, of which 44% came from user fees, 31% from general taxes, and 25% from specialized transportation taxes. Local governments were far more likely to depend on general revenues to fund their transportation programs than states or the Federal government. States and local governments also were more dependent on specialized transportation taxes and fees to support transportation

expenditures than the Federal government (Cambridge Systematics, 2006). While the Federal government began supporting public transit capital and operating subsidies primarily from general revenues, it later decreased its reliance on general funds for public transit by creating the transit account within the Federal Highway Trust Fund, which is of course almost entirely funded by user fees on highway fuels and vehicles.

A recent report by the Government Accountability Office (GAO) summarized trends over the past decade in the use of transportation revenues from different sources. The report reveals that revenue from specialized taxes to support both highways and transit grew more rapidly than either user fee revenue or revenue derived from general taxes. For example, while motor fuel tax revenues used for highway programs rose by an average annual rate of 2.4%, transportation sales taxes and other specialized taxes devoted to funding highways rose at an annual rate of 7.5%. By contrast, revenues from property taxes that were devoted to the support of highways rose by only 4.4% annually. For public transit, revenues from fares rose by 3.5% annually over the decade, and those from motor fuel taxes also rose at 3.5% annually, while transit revenue from sales taxes rose by 8.5% annually (Government Accountability Office, 2003).

It is important to acknowledge that most countries levy much heavier taxes than does the United States on fuels, trucks, cars and replacement parts for vehicles. Yet, most countries place the proceeds of these taxes into their general funds, mingling them with other taxes and fees of many sorts. These countries also finance transportation investments from their general funds. The explicit statutory linkage between “user fees” and transportation investments in the United States is rare among all the countries in the world, yet is an arrangement that is growing elsewhere as other countries, including Japan, New Zealand, and others, increasingly emulate the American pattern. Reliance on user fees for transportation finance is so important and powerful in the United States that a dramatic shift toward dependence on general funds for transportation finance is difficult to imagine. It would constitute a fundamental change in culture of transportation that would reverse a pattern that is widely accepted and that has withstood many debates over seventy years or so.

The mood of the electorate has widely been portrayed in the US as being opposed to most increases in taxation, but this generalization is not precisely accurate. It is certainly true that thirty years ago voters participated quite actively in some “tax revolts” typified by Proposition 13 in California. Statutory limits on rates of growth in such general taxes have been enacted in some jurisdictions and this provides context for the pattern revealed by the GAO report that was cited above. Limits on the growth of tax revenues have become even more consequential by an increase in what is widely referred to as “unfunded mandates.” As the federal and state governments increase regulation and place more requirements on lower levels of government, those governments must fulfill more responsibilities and provide more services from general fund sources even as voters press to reduce tax levels and rates.

As if the general revenue picture were not sufficiently complicated because of all the foregoing trends, it is also important to mention the growing prevalence of term limits. Elected officials, often thinking about running for offices other than those they presently hold, prefer to make do with current rates of general taxation while in office, even when that means that some important public programs cannot be well funded, leaving their successors to deal with the consequences.

For all these reasons, we can project that general revenues of government will remain a source by which to partially fund transportation, especially public transit, yet it would be difficult to envision such general taxes producing enough revenue to counter the growing gap left in transportation finance by the declining real value of user fees.

But there has also been a counter trend that involves a gradual increase in specialized or earmarked taxes, often directly placed on electoral ballots for approval by the voters. By placing measures on the ballot for voter approval, elected officials can avoid “taking the heat” for raising taxes. By approving special taxes and fees, like earmarked sales taxes, voters can be assured that everyone is paying their full share. This general trend has resulted in a steady increase in the approval of specialized taxes for a wide variety of public programs, especially transportation.

Ballot Measures and the Growth of Local Option Taxes

A surge in local and state ballot measures has been taking up at least some of the slack caused by the relative drop in fuel tax revenues at the state and federal levels that is more fully developed in paper 5A-02. Before 1980, few states encouraged or even permitted their cities or counties to levy their own transportation fees, except for property taxes traditionally used for neighborhood streets and county roads. In the 1970s, several major metropolitan areas adopted permanent sales taxes to support the development of new transit systems. In the 1980s, several states authorized local jurisdictions to use ballot measures to raise revenues for transportation purposes. The pace accelerated during the 1990s as 21 states either adopted new laws authorizing local option transportation taxes or saw dramatic expansion in their use (Goldman and Wachs, 2003)

During calendar year 2002, American voters considered 44 separate general transportation tax ballot measures and in calendar year 2003 they considered 43 more. This trend is continuing, and in 2006 voters directly considered another 30 such measures. Over the past six years, voters in 33 states have approved 70% of the transportation measures on which they were asked to vote, and the Center for Transportation Excellence estimates the revenue proceeds from these measures to be about \$70 billion (Center for Transportation Excellence, 2006). While the majority of these measures were approved, some of them were second, third and even fourth attempts to approve measures that earlier had been rejected by the voters.

Only a few of these ballot measures involved approval of user fees like fuel taxes. Local sales tax increases were by far the most common taxes considered in these measures, but some voters also enacted vehicle registration fees, taxes on real property, sales, local income or payroll taxes earmarked for transportation, and taxes on new real estate developments.

In California, residents of 17 counties – home to 85 percent of the state’s population – have voted to raise their sales taxes between one-quarter and one percent - to pay for county and city transportation improvements. Collectively, these measures are producing roughly \$2 billion per year for capital investment in new highway and transit facilities and maintenance and operation of existing ones. These sales taxes are the fastest growing source of money for transportation in California, and in many other states as well. The popularity of local specialized sales taxes for transportation can be attributed to four important characteristics:

- 1) *Direct local voter approval:* These measures typically result in projects and services near voters' homes and work places, so they personally can appreciate them and anticipate their benefits. In an era of growing distrust of politicians, these measures provide tangible direct local benefits.
- 2) *The taxes have finite lives:* Voters enact transportation taxes that will persist typically for fifteen or twenty years unless specifically reauthorized by another popular vote. Voters thus have a sense of control over their money. If projects don't live up to their expectations or if they fully accommodate growth and reduce congestion, the taxes could end.
- 3) *Specific lists of transportation projects:* The taxes may be used only to build certain projects or fund specific programs named in the ballot measures, and politicians' discretion to spend the money is severely limited.
- 4) *Local control over revenues:* The money raised locally is spent locally and for local benefit, under the control of a local transportation authority, assuring citizens that the money will not leak into other jurisdictions.

These provisions give voters more direct control over transportation investments than is typical with general fund monies or motor-fuel taxes, though this direct control stems from the local voter approval process and not the fact that the funds are typically raised from non-transportation sources. Nonetheless, surveys of voters and interviews of local politicians regarding these measures find that local control is the single most politically attractive aspect of local option transportation taxes (Hannay and Wachs, 2007).

Sales taxes are also lucrative because they have a broad base. While fuel taxes are paid only by motorists making fuel purchases, sales taxes are paid by many more people purchasing a much wider range of goods. Thus, even small sales tax increases can generate significant sums of money. One county, for example, estimated that a one-percent general transportation sales tax there produces as much revenue as would a motor fuel tax increase of sixteen cents per gallon. While the annual tax paid by households might be the same under each of these tax changes, small increases to a frequently paid tax have proven to be much more palatable politically (Crabbe, et al, 2005).

Special transportation sales taxes have supported a wide variety of projects, with a fairly even split among highways, local roads, and public transit. Measures adopted earlier generally earmarked revenue for specific projects listed on the ballot (such as a road widening or railway grade crossing elimination), while more recent measures have more frequently allocated funds for "program categories," or less explicit groups of uses and projects, such as "maintenance and repair," or "traffic signal timing improvements"(Crabbe et al, 2005).

The most consistent trend in sales-tax expenditures shows operations and maintenance of existing facilities receiving far less funding than new capital projects. Voters are believed to favor measures that create new rail lines or new highway capacity, while many believe that they are unimpressed by plans to restripe pavement or repave deteriorating road surfaces. While these generalizations are often repeated, the content of expenditure plans varies widely among jurisdictions and from measure to measure, reflecting differences in local priorities. Rural

counties are more likely than urban ones, for example, to put control of special tax revenues in the hands of local jurisdictions and to spend most of their revenues on highway projects, streets, and roads rather than on public transit (Crabbe, et al, 2005).

Jurisdictions that collect and administer specialized transportation taxes typically designate a transportation authority to oversee use of the funds. In California, County Transportation Commissions or Authorities typically build improvements themselves, relying on their “measure money” rather than relying on the California Department of Transportation (Caltrans), and proponents cite this shift of authority from state to counties as a major benefit of specialized transportation taxes. Transportation authorities typically claim a number of advantages over the state in developing and delivering projects, including greater sensitivity and flexibility responding to local needs, less institutional inertia, and flexibility to pursue environmental review and design simultaneously rather than sequentially. Thus, the creation of more localized transportation authorities has significantly expanded the planning and delivery of transportation improvements at the county level (Crabbe, et al, 2005).

Policy Consequences of the Shift To Local and Specialized Transportation Taxes

Raising transportation revenues through local special tax measures creates clear incentives to support projects that produce local benefits. Voters clearly favor projects that deliver tangible benefits to them. This type of financing gives lower priority to projects within local jurisdictions for which benefits accrue largely to through travelers. For example, one of the factors resulting in the defeat of a local transportation sales tax measure in Northern Virginia in 2003 was the argument made loudly by opponents that people would be taxing themselves locally to alleviate the impacts of congestion caused largely by heavy trucks passing through Northern Virginia on trips taking them between New York and Atlanta (Nelson, et al, 2003). For a number of reasons, therefore, recent growth in the use of local specialized taxes to provide revenue for transportation programs seems well suited to the support of public transit programs since they generally provide benefits that are concentrated within a locality or region. In contrast, local specialized tax measures seem poorly suited to the raising of capital for projects that alleviate congestion or improve service on routes or facilities that serve long-distance interregional travel, as do many major interstate highways. While a useful tool by which to raise transportation revenue, local specialized transportation taxes are not an appropriate substitute for any and all alternative forms of transportation revenue, particularly for projects of national significance.

Supporters tout the benefits of enumerating specific projects in the ballot measures. But in approving project lists voters also limit the transportation agencies’ flexibility to respond to changes in conditions or needs during the life of the measures. All but five of California’s county level transportation sales taxes earmark some amount of revenue for specific projects, limiting the power of transportation authorities to reset priorities after the tax has been approved (Crabbe, et al, 2005). Revenue shortfalls, cost escalations, or changing political sentiments about projects may mean that over time agencies will want to deviate from the list of voter-approved projects. Transportation authorities face pressure to expend funds in accordance with the ballot measures and to deliver on the commitments made by local political leaders regardless of changing budgets or shifting political priorities. This pressure can have serious drawbacks. There can be many obstacles to the completion of projects administered by transportation authorities, and under most of the ballot measures that create the specialized taxes, the transportation authorities are not usually required to base their implementation priorities on project cost-effectiveness nor

to spend sales tax revenues on mitigating potentially damaging environmental consequences of voter-mandated projects.

Transportation tax referenda around the nation are often assumed to be nothing more than a new and politically expedient way of raising needed revenue. They are called upon to fill the gap in revenue created by slowing rates of increase in motor fuel taxes coupled with improved vehicle fuel efficiency. In other cases special taxes are used to replace revenue streams that fail to increase because of the limited growth of general fund revenues. But, increasing reliance on local option transportation taxes may be doing much more than providing useful revenue. In addition to raising needed money, they are gradually but inexorably changing the way we plan and finance transportation systems in several fundamental ways:

The growing popularity of specialized transportation taxes, especially sales taxes, is gradually but steadily shifting the financial base of our transportation system from user fees to taxes paid by all citizens, regardless of their direct reliance on the transportation system. Economists have long argued that user fees have at least some tendency to induce more efficient use of the transportation system; higher fuel taxes might, for example, encourage motorists to acquire more fuel-efficient vehicles. In contrast, sales taxes provide no incentive for greater transportation efficiency of any sort.

While sales taxes and fuel taxes are both income regressive (meaning that people having lower incomes pay a higher proportion of their incomes in each of these taxes than do people having higher incomes), the effects on the poor of user fees are tempered by the fact that those who pay them always benefit from them, while sales taxes burden non-users as well as users.

The growing use of specialized transportation sales taxes and the growing role of metropolitan transportation planning are consistent with a national trend toward devolution of transportation decision-making authority, but federal policy and the rise of local specialized tax measures are in fundamental conflict. While Congress and many states are devolving transportation decision making to the regional level by enhancing the powers of metropolitan planning organizations, county and municipal sales taxes can actually undermine the influence and authority of those organizations by focusing resources and decision-making on counties and other smaller units of government.

Special local transportation taxes are increasingly limiting the transportation policymaking authority of elected officials by requiring that transportation funds be spent strictly in accord with the language of the ballot measures over fairly long periods of time. And project lists are gradually eliminating the flexibility necessary to adapt to changing needs.

While transportation planners and engineers often apply analytical procedures like benefit-cost analysis to determine which investments should be selected, ballot measures proposing local transportation taxes substitute election campaigns —sometimes derisively called “beauty contests”— for such systematic analysis. Many believe that greater reliance should be placed on analysis of project cost effectiveness, but by listing popular projects in the sales tax measures, we are gradually limiting the relevance of systematic financial analysis in project selection. While local control and direct democracy are American ideals, it is probably not appropriate for voters

to preempt the application of technical expertise in the design and management of transportation systems.

Conclusion

The financing of transportation systems in the United States is a massive and costly endeavor. Contributions are made from many sources and the financing system is best described as a partnership of sorts. Important public projects are often funded by numerous jurisdictions and many sources of funds. While user fees have in recent decades dominated federal and state resources expended on transportation, those units of government have, although to a far lesser extent, also employed general funds and specialized general taxes to support transportation. Local governments have relied much more heavily on general taxes and specialized transportation taxes rather than user fees. Local streets and roads and local public transit systems are much more likely to be partially or completely funded by such general and specialized taxes.

In the medium to longer term, it is not likely that many states or the Federal government will substantially increase their reliance on general revenues or upon general taxes, like sales taxes, that are earmarked for transportation uses. There are many demands on Federal and state budgets for programs and services, like education and health care, that cannot easily be fully funded by user fees, and at the same time there is great and lasting political reluctance to raise rates of general taxation. There also is a broad consensus that the transportation system should be largely user financed and charges levied against users contribute to the efficient use of the transportation system.

Despite this, general government revenues make a critical and long-term contribution to transportation finance, especially at the local level. Local streets and roads make up the vast majority of miles of roadways in the US, and they are largely funded by general government taxes. In many jurisdictions, local general funds are also a dependable and continuing source of support for public transportation systems. It is reasonable to expect that these fundamental elements of the transportation system will continue to be largely supported by general revenues even though general revenues will not increase dramatically as a proportion of all transportation funding.

Recently, increases in general taxes that are specially earmarked for transportation, such as county transportation sales taxes, have filled an important gap by allowing total transportation funding to increase as user fees have grown at a decreasing rate in relation to costs and inflation. It is likely that these kinds of taxes can continue to be called upon, especially at the local level, especially for projects producing local benefits and especially for public transit. But, there is a practical, political upper limit on the extent to which such taxes can be employed to support the growth of transportation systems. Jurisdictions will not tolerate general taxes for transportation that exceed a few percent of sales because there is great competition for revenue by non-transportation programs at the local level and because sales taxes can become high enough in some jurisdictions to threaten their economic growth. Such taxes are and will be a significant and continuing source of revenue, but they cannot replace user fees over the longer term.

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CONSOLIDATED COMMENTS FROM MEMBERS OF THE BLUE RIBBON PANEL OF TRANSPORTATION EXPERTS on PAPER 5A-10

Several reviewers combined their comments as follows:

The use of sales taxes and general revenues for transportation purposes to supplement user fees is becoming increasingly common, because the greatly increased cost of gasoline and diesel fuel has resulted in a decline in revenue from these sources. The high cost of gasoline is making it very difficult politically to increase fuel taxes at both the state and federal level. This problem has been compounded by public demand for fuel efficient vehicles including hybrids.

Sales taxes have been used more frequently for mass transit projects since the 1970s. Atlanta's MARTA system relies entirely on this source for operating assistance and the non-federal share of capital needs, including the construction of rapid transit lines. MARTA does not receive any financial help from the State of Georgia. One problem of relying on the sales tax is that when the economy slows, revenues from this source decline. This has been a major problem for MARTA, and explains why there has been no expansion of their rapid transit system since 2001.

San Francisco's BART is another example of relying on the sales tax. The original system was funded primarily from property taxes approved by voter referendum, but sales taxes became necessary to supplement property taxes to complete the system and build four extensions during the 1990's to the present.

Politically, it is becoming increasingly difficult to raise property taxes, because rising property values increase the cost to the owner. This problem is becoming greater because of the large and increasing number of retired people who live on fixed income.

Specific comments:

- Page 4 – California data should be updated. Local sales tax measures now provide over \$3 billion a year. See: http://www.lao.ca.gov/2007/ca_travels/ca_travels_012607.pdf , pp. 29-30.
- Page 6 – The assertion that “...local specialized tax measures seem poorly suited to the raising of capital for projects that alleviate congestion or improve service on routes or facilities that serve long-distance interregional travel...” is not supported by the California experience (for example, in Orange County), where numerous capacity expansion projects on interstate and interregional state routes were paid in large part by local transportation sales taxes – in fact, inclusion of such projects was a major selling point to voters.
- Page 6 – Newer transportation sales tax measures in California typically have “re-opener” clauses that allow periodic adjustment of projects and expenditures if priorities change, usually requiring concurrence of voters or of cities and counties.