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CONGRESSIONAL TESTIMONY

Should Congress Raise the Federal Gas Tax?

Testimony before
Committee on Finance
United States Senate

June 18, 2015

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My name is Stephen Moore. I am a Visiting Fellow in Economics at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

Mr. Chairman, with gas prices having fallen by roughly $1 a gallon over the past year, many policymakers are advocating a rise in the federal gas tax. Earlier this year House minority leader Nancy Pelosi argued that motorists might not even notice the hike. "If there's ever going to be an opportunity to raise the gas tax, the time when gas prices are so low — oil prices are so low — is the time to do it," she stated.

This seems to be the argument that if OPEC can't keep prices high, the Feds will. But there's a good reason why polling stands overwhelming against raising the 18.3 cents a gallon federal gas tax. It hurts the finances of the middle class. The best rule of thumb is that every penny rise in gas prices at the pump takes about $1.5 billion out of the wallets of consumers. So a 10 or 20 cent gas tax will take about $15 to $30 billion from consumers. That's a massive negative stimulus to the economy at a time of stagnant wages for a decade in America.

By the way, the fall in the gas price increases federal revenues because people drive more when the price is lower, and the per gallon federal gas tax collects more funds. So if anything, a fall in gas prices should be coupled with a fall, not a rise in the federal gas tax.

Proponents of higher gas taxes point to the fact that the federal gas tax hasn't been raised since 1993 and hasn't kept pace with inflation. That's true, but the federal funding peaked at just about the time the 42,000 national interstate highway system was just being completed. So the feds need less money now than 30 years ago. No one argues that we should be spending today what we did in the 1960s on the Apollo moon landing mission.

Moreover, states have raised their gas taxes and funding for roads in most areas is not inadequate. From 1984-2012, across the country, the pace of increase for capital expended on roads and bridges has been nearly triple the inflation during this period (330 percent vs. 121 percent). And this occurred during a stretch where the nation's population grew by only one-third. The common refrain from the road builders and civil

engineers is that the infrastructure is crumbling and that we need to spend hundreds of billions more. Actually, as my Heritage colleagues have noted in recent reports:

While the common perception is that America's infrastructure is "crumbling" and thus requires more federal expenditures, the reality is not nearly as bleak. Some infrastructure certainly requires maintenance and updating, as congestion is a major concern in many metropolitan areas. Indeed, the federal government provides perverse incentives for states to spend billions on new, unneeded projects instead of maintaining existing systems.

Taken as a whole, the nation's infrastructure performs well and is improving. The percentage of bridges that are structurally deficient—meaning that they require extensive maintenance, but are not necessarily unsafe—has declined from 22 percent in 1992 to 10 percent in 2014._ Highways and roads have also improved: The Federal Highway Administration notes that the percentage of vehicle miles traveled on the National Highway System with "good" ride quality rose from 48 percent in 2000 to 60 percent in 2010, while the share with "acceptable" ride quality increased from 91 percent to 93 percent.

What is true is that America needs more roads because congestion is getting worse over time and this is a clear economic drain on the U.S. By some estimates the average American worker must work the equivalent of an extra week a year (37 hours stuck in traffic congestion) due to crowded roads and highways. But that problem can also be solved through smart tolling and other market incentives to properly price use of the infrastructure during peak commuter hours to reduce overcrowding.

In 21st century America, tolls are the most efficient form of user pays and Uber-type technologies make tolling highly efficient in terms of adjusting prices during peak hours to reduce congestion. By the way as we move into the new era of cheap, reliable, safe, and smart Google Cars on the roads, time delays due to congestion will be much less of a problem in the future.

But the reason roads aren't being built is not that the money is insufficient. It is that so little of the gas tax dollars actually go to building and maintaining roads.

Consider the highway spending dollars for 2015. The gas tax is expected to raise roughly $39 billion in 2015. Is this enough to build and repair needed federal roads? Yes,

but it is not enough to fund transit projects - most of which are hugely inefficient and should never be funded with federal dollars and certainly shouldn't be funded by motorists, who, by definition, don't use the trains, and subways and buses.

Under current law, the Highway Trust Fund consistently spends more on road and transit projects than it receives in fuel tax revenues and is expected to run a cumulative deficit of $180 billion over the next 10 years if current trends continue.

The Highway Trust Fund is divided into two accounts. The Highway Account is slated to disburse about 85 percent of combined spending on roadway infrastructure and other projects in 2015. The Mass Transit Account expends about 15 percent of spending (about $8 billion a year) and funds transit projects, such as rail, buses, and streetcars. This is not based on fairness or good transportation policy. It is based on the political clout of urban politicians in Congress who have come up with funding formulas that benefit their districts.

Overall, about 25 percent of fuel tax funding is diverted to non-highway projects - including bike paths, trails, museums, and so on. These may be very worthwhile projects, but why should gas and diesel tax revenues fund them?

Congress should begin addressing the highway funding shortage by insuring that every dollar of gas tax paid by motorists goes to building the roads that they make use of. That is what a "user fee" is intended to do.

The argument is made by transit advocates that transit projects help reduce congestion on roads and therefore benefit motorists. In very few cities is that the case, because outside of cities like Chicago, New York, Washington, D.C. And San Francisco, so few Americans use mass transit. Moreover, often times building an extra lane of highway would reduce traffic congestion in rubber neck areas at one-tenth the cost of massive white elephant transit projects.

Moreover, there is another massive inefficiency in the transit program. States and cities are paid a much higher reimbursement rate for capital expenditures than operations. So the incentive is to build gold-plated rail services with multi-billion construction costs than to operate buses and other van shuttle services at a fraction of the cost. This explains why two of the greatest rail flops of all time are being built today: the $70 billion high speed rail project in California and the Dulles Airport "silver line" in Virginia that is only

being constructed because the feds are giving billions to the state of Virginia. If people in the metro area had to pay for this boondoggle, they never would have allowed their tax dollars be so misallocated. By they way the project has already had four cost overruns.

These two examples, and multiples more, explain why transportation funding and planning needs to be turned back to the states. Again, this comports with the user pays principle of transportation which we have strayed so far from and has encouraged wasteful spending.

We know, by the way that states differ dramatically in how efficiently they spend on roads and highways. In my book with Arthur Laffer, et al, called *The Wealth of States*, we document that California spends about twice as much per mile of highways built than Texas (about $250,000 in CA versus less than $100,000 in TX). Despite the spending discrepancy, Texas road conditions are ranked 23rd in the nation and California's are ranked dead last. What does California get for all that spending? Not much. This gap between Texas and California is due to environmental and labor rules, among other things. States can get away with being inefficient if they are being subsidized by the feds. They will have to get lean and efficient if they are paying for their own fiscal folly.

There is another way to reduce highway construction labor costs by as much as 20 percent, and this is by repealing the federal Davis Bacon Act, which requires effectively a union "prevailing wage" be paid on federal construction projects.

<u>No to a Federal Infrastructure Bank</u>

One idea kicking up steam is the notion of an infrastructure bank to fund road, transit, green energy and other brick-and-mortar "shovel-ready projects." The idea is that over time this could raise about $150 billion for federal infrastructure projects.

One typical plan, sponsored by Rep. John Delaney of Maryland, would create an infrastructure bank funded with $50 billion, leveraged to backstop 50-year bonds that would finance billions in new transportation projects.

The Obama administration has a similar plan to create a bank funded by $150 billion of repatriated taxes on overseas profits of U.S. multinationals. The $150 billion would collateralize tens of billions of dollars of long-term loans from private investors that would fund up to $100 billion of new projects each year.

The White House says that this plan could nearly double funding for highway and transit projects with this magical stash of funds. The supposed selling point: After the initial funding, taxpayers wouldn't have to put up a dime; it would all be paid for with private dollars collected.

Except for the fine print. The full faith and credit of the U.S. government would back these loans. If the bank experiences financial stress, the government would be on the hook to repay the loans. As Ronald Reagan would say: "Well, there they go again".

This was exactly the financing mechanism that propped up Fannie Mae with its scam arrangement of 100% taxpayer guarantees on subprime mortgages. Obama's budget chief once wrote that the chances of a Fannie Mae default were close to one in a million. It was supposed to be free money for housing -- until it wasn't.

Now, $150 billion in losses later, we know that Fannie and its sister organization Freddie Mac required one of the most expensive taxpayer bailouts in American history. This is anything but a model worth imitating.

A close inspection of many of these infrastructure bank proposals indicates that rather than investments being based on sound financial justifications, politics will play a major role.

The infrastructure bank is to take into account factors including reduction in carbon emissions and income inequality, job training for low-income workers, energy efficiency, expanded renewable energy and requirements that iron, steel and other inputs be produced in the U.S.

The feds already provide a giant subsidy for local infrastructure projects via the tax exemption on municipal bonds. It lowers the interest rates that cities and states must pay on their infrastructure bonds. Rates in the muni market have fallen sharply, from 5.41% in 2011 to 3.6% last month -- the lowest borrowing costs in nearly half a century.

A Better Way Forward

Rather than raise the federal gas tax, a better policy would be to phase down the federal tax and let states pay for their own road projects. The interstate highway system was completed 30 years ago and there is no more need for a national tax at 18.34 cents a gallon to fund bridges and high speed rail projects to nowhere. Turning back

transportation projects to the states will ensure that gas tax money is used for the highest value added projects.

Under one current proposal, over the course of five years, the federal fuel tax rates would decrease, from 18.3 cents per gallon to 3.7 cents per gallon (gasoline) and from 24.3 cents per gallon to 5.0 cents per gallon (diesel). At the same time, federal programs more appropriately run by states and cities, such as subway, bus, and bicycle programs, would end. Authority and accountability would return to states and localities, giving them incentives to fund projects according to local priorities, not those of Washington.

States would decide whether to increase state fuel taxes by the amount the federal fuel taxes decreased, such that motorists would see no change at the gas pump. Or they could raise additional funds or pursue other revenue-generating mechanisms—user fees or taxes—to meet the level of transportation revenue they deem necessary to carry out their priorities. In general, states should maintain the "user pays, user benefits" concept and should not raise unrelated taxes, such as a generic sales tax, to fund transportation. projects

One last point when it comes to our "infrastructure crisis.". I can't help noting that it is many of the same politicians, starting with President Barack Obama, who keep clamoring for more infrastructure spending to create jobs and make America economically sounder, who also oppose the Keystone XL pipeline. This is a project that could create well more than 10,000 jobs, that would increase American energy exports, and would increase U.S. National security - and would not cost taxpayers a dime - and many in Congress and in the White House oppose it. We ought to do the cheap and easy infrastructure projects first.

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