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BTC Brief

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STAYING IN THE FAST LANE: Gas Tax Cap Would Delay Needed Repairs and Weaken North Carolina's Transportation Budget

*Timely,
accessible,
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analysis of
state and local
budget and tax
issues*

KEY FINDINGS:

- North Carolina's transportation budget faces a funding gap. Since the Great Recession, North Carolina has not experienced gradual increases in revenue collections from the gas tax as generally experienced in pre-recession years. The purchasing power of construction and maintenance dollars has also eroded.
- Despite revenue shortfalls for transportation projects, the price-based component of the state's gas tax has helped North Carolina sustain revenues to better keep pace with transportation needs. Capping the gas tax would prevent revenues from adjusting to rising construction costs.
- The price-based component of the gas tax is variable and therefore results in great volatility. Placing a cap on this component of the gas tax—rather than the overall gas tax—would smooth volatility and lead to a more stable and predictable rate.

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North Carolina's Transportation System is Strained

Often called the thread that knits the country together, transportation systems connect people to their families, jobs, and communities. Although North Carolina has been known as the Good Roads State, its transportation system is under considerable pressure due to aging infrastructure, increasing demand, and declining revenue sources that are failing to keep pace with rising costs to maintain and improve the system.

Despite these challenges, lawmakers are expected to place a cap on the state's gas tax, which accounts for more than half of state revenues dedicated for transportation projects. This move would follow Governor Perdue's call for capping the gas tax at 37.5 cents in her recommended adjustments to the FY2012-13 state budget.

Although the state's gas tax is in need of reform due to its volatile nature, capping the gas tax would delay progress toward reducing congestion and rebuilding the state's crumbling transportation infrastructure. The already-existing funding gap in the transportation budget requires consideration of alternative options that would replace lost revenue to meet the transportation needs of a growing state.

North Carolina's Gas Tax

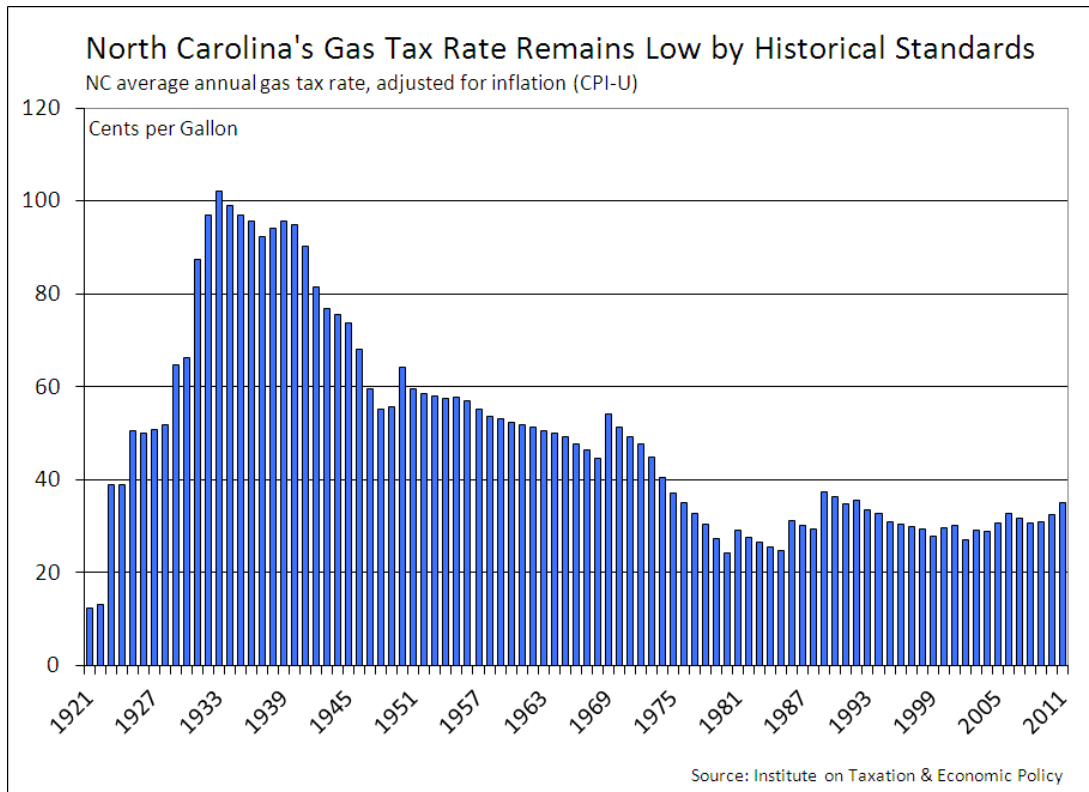
Initially levied in 1921, North Carolina's gas tax is a major revenue source for transportation projects like repairing bridges, repaving roadways, and building highways and transit. The gas tax rate is currently 38.9 cents per gallon. Each penny of the gas tax yields approximately \$50 million annually.¹

There are two components to the state's gas tax: a flat tax of 17.5 cents per gallon, and a variable portion that is adjusted twice a year to equal 7 percent of the average wholesale price of gasoline over the previous six-month

period.² The gas tax is pegged to the wholesale price of gas because the cost of road maintenance and construction is linked to the cost of crude oil and petroleum-based materials, especially asphalt.³

In North Carolina, revenues generated by state and federal gas taxes make up nearly 75 percent of total transportation funding.⁴ Three-quarters of the revenues from the state’s gas tax are deposited into the Highway Fund for road maintenance, public transportation and five intermodal divisions, while the remaining quarter supports the Highway Trust Fund to fund road construction.⁵

The gas tax rate has generally increased steadily over time but remains low by historical standards when adjusted for inflation.⁶ As illustrated in the chart below, recent gas tax rates appear to be high only in comparison to a brief period of low gas taxes in the early 1980s. The most recent AAA survey shows North Carolina’s average gas price closely mirrors the national average. This suggests that capping the gas tax may have little impact at the pump.⁷



Revenue Uncertainty and Eroding Purchasing Power

Since the Great Recession, North Carolina has not experienced gradual increases in revenue collections from the gas tax as generally experienced in pre-recession years. The Department of Transportation does not expect transportation revenues to reach pre-recession levels until FY2013-14—a date that may be pushed back because gas tax receipts and motor vehicle fees are coming in under projections.⁸ The FY2011-13 certified biennial budget for transportation was revised downward by \$163 million to account for lower-than-expected gas tax receipts and fuel consumption.⁹

The transportation revenue shortfall is due to many factors such as elevated gas prices, the shift toward more fuel-efficient and hybrid-electric vehicles, and the lingering impact of the economic downturn, which prompted many people to drive less.¹⁰ For instance, the number of taxable gallons sold in North Carolina in 2010 was 0.5 percent less than the number sold in 2007.¹¹ The latest available data show the number of vehicle-miles traveled in North Carolina declined by 1.7 percent from February 2011 to February 2012, compared to the 1.8 percent increase experienced by the nation.¹²

The revenue shortfall is particularly acute because the cost of construction and materials has been rising and is projected to continue rising. From 2003 to 2011, the state’s purchasing power of highway construction dollars decreased by 43 percent.¹³ The revenue shortfall is also critical because of growing demand: the state’s total population is expected to grow 21 percent by 2030.¹⁴

Other Major Strains on the State's Transportation System

The fiscal pinch of rising road construction costs hits North Carolina particularly hard because the state owns more than 79,000 miles of roads, second only to Texas and more than any neighboring state. This represents 76 percent of all road miles in the state. In comparison, the average state owns approximately one-fifth of all roads within its borders. For these reasons, North Carolina relies more heavily on the gas tax as a revenue source to fund road construction and maintenance.¹⁵

Another strain on the state's transportation system is its aging infrastructure. More than 5,000 of the state's 13,000 bridges are structurally deficient or functionally obsolete. In 15 of the state's 100 counties, more than half of the bridges are in such poor conditions.¹⁶ In addition, more than one-third of the state's primary and secondary roads are in poor or mediocre condition. If transportation funding remains at current levels in the state, the share of pavement miles in good condition is projected to fall from 2 in 3 to 1 in 2 by 2017.¹⁷

North Carolina ranks 48th in the country in spending per lane-mile of paved road.¹⁸ This lower-than-average level of spending is evident in the American Society of Civil Engineers' 2009 report card: the state received a C- for its bridges and was downgraded on its roads from D to D- and on its rail from B- to C.¹⁹ Infrastructure health not only has an impact on safety but also on motorists' pockets. Annually, poor road conditions cost North Carolina drivers \$1.7 billion in additional repairs and operating costs.²⁰

Risks Associated with Capping the Gas Tax

The Department of Transportation recognizes that current transportation revenues are inadequate to address the maintenance and repairs backlog. In fact, just to maintain current conditions over the next 30 years, the department estimates it needs an additional \$32 billion over the baseline revenue forecast to plug the funding gap.²¹ Per Governor Perdue's FY2012-13 budget proposal, North Carolina would miss out on \$63 million in revenue during the next fiscal year if the gas tax is capped at 37.5 cents.²² In light of the already-existing funding gap, a permanent or long-term cap on the gas tax would further delay much-needed repairs and upgrades.

Despite revenue shortfalls for transportation projects, the price-based component of the state's gas tax has helped North Carolina sustain revenues to better keep pace with transportation needs. Capping the gas tax would prevent revenues from adjusting to rising construction costs.²³ A cap on the gas tax also risks the adequacy of funding for other state-supported public investments. Recently, Nebraska, Utah, and Wisconsin diverted funds away from their general funds to make up for flat transportation revenues.²⁴

One downside of the price-based component of the state's gas tax is price-related volatility. North Carolina's gas tax rate has varied considerably lately, making it harder for the state to manage its transportation system and for families to manage their household budgets. Statutorily required recalculations in the gas tax rate over the last five years led to large changes in the rate, ranging from -8.7 percentage points to 11.1 percentage points from the previous period.

West Virginia and Kentucky managed such volatility by limiting changes in their gas tax rates to 10 percent or less.²⁵ Placing a cap on the variable component of the gas tax would lead to a more stable and predictable rate while allowing the price-based character to be preserved more so than if the state capped the overall gas tax rate.

However, the Department of Transportation expects gas tax receipts to decline after 2020 as the shift toward more fuel-efficient vehicles accelerates.²⁶ Thus, North Carolina will need to rely less on the gas tax as the primary means of financing transportation projects over the long term.

Conclusion

Life in North Carolina would be far different without a transportation system that connects people and businesses to opportunities across regions and surrounding states. To build and maintain a reliable transportation system that is efficient and safe for motorists, it is important for lawmakers to maintain a gas tax that generates sufficient revenue to address growing demand and the current backlog of stressed roads, bridges, and railroads. If lawmakers fail to finance transportation investments responsibly, North Carolina may face a dramatic decline in its transportation system and experience more congested roadways that translate into significant costs to motorists.

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