Policy Perspective

No. 1002 August, 1997

# Market-based reforms needed to solve transportation finance crisis

by John A. Charles
*Environmental Policy Director*

Recently Gov. Kitzhaber met with several hundred top managers at the Oregon Department of Transportation (ODOT) to discuss the transportation finance proposals that were rejected by the Oregon legislature this year. Afterwards, ODOT director Grace Crunican spent nearly two hours showing videotapes of legislative hearings to her staff

Unfortunately, they are not likely to learn very much from the tapes, because most of the legislative hearings were irrelevant to the real problems of the system. The governor's legislative proposal focused exclusively on raising more revenue through higher taxes, but lack of money is not the problem. The problem is that we don't use market mechanisms to collect and allocate transportation user fees. Until the legislature allows markets to function, the system will continue to deteriorate.

## Follow the money

The Oregon system treats transportation as a monopoly: the government owns the roads, collects motor vehicle taxes, and provides most transit service. Because of this, pricing is not market-based. Revenue is generated through a mishmash of fuel taxes, federal grants, payroll taxes, vehicle registration fees, and forest harvest receipts. The system is rife with back-door subsidies which prevent people from knowing what it actually costs to use specific services . Without such information, motorists and transit users have no incentive to economize on their use of resources, and government bureaucracies have no incentive to become more efficient.

Moreover, even if transportation users knew what it really cost to provide them with such services, they would not be able to "buy" more of them, because the system is not responsive to price signals. The 24 cent state gas tax, for example, generates funds that are simply dumped into a pot in Salem and then distributed to ODOT, cities and counties through a formula. ODOT gets 59%, and local governments get the rest. This means, no matter how badly your local road may need maintenance, or how much you are willing to pay in gas taxes, there is no guarantee that any of your tax money will be spent to fix your road. All such decisions are made by politicians and bureaucrats in a political process far removed from the consumer. The result: money flows to its highest *political* value, not its highest *economic* value.

Elsewhere in the economy things work very differently. If you buy a gallon of milk, you send a signal to the milk producer that the next time you shop, you'd like more milk available. That's why we rarely see milk shortages. If your money was simply diverted by the store manager for some other use, the dairy farmer would stop producing milk.

If we want our transportation system to become more efficient, we must introduce market mechanisms that allow people to vote with their wallets for what they want, regardless of what politicians want. Here's how we can get it.

## Replace taxes with user fees

First, begin by reducing or phasing out the state gas tax and replacing it with road user fees (tolls) on the most heavily traveled highways. These fees can be easily collected through electronic tolling devices that eliminate the need for old-fashioned stop and go toll gates. Such systems are now in use in Oklahoma, New York, Texas and California.

The key advantage of electronic tolling is that the billing system can collect the specific costs of using a particular road at a particular time. Highway user costs vary dramatically depending on such factors as time of day, direction of travel, and weight per axle of the vehicle. Unless the user fees are adjusted to capture these variable costs as they actually occur, everyone will either be over-charged or under-charged.

That's the primary problem with the gas tax. It is a retail sales tax that is not linked to a specific facility. Heavy trucks, motorists with studded tires, and peak-hour drivers all place extraordinary demands on facilities, but a flat tax on gasoline does not distinguish between the different types of demands.

Electronic tolling solves this problem. For example, if tolls rise during the peak period on a crowded urban highway — a concept called congestion pricing — motorists will have an incentive to car pool, take a bus or eliminate low-value trips. This behavioral shift will reduce or eliminate congestion, which will make most users better off.

Similarly, if tolling is used to collect axle-weight fees from heavy trucks (which we already do in Oregon), truck operators will have incentives to spread weight out over more axles, which reduces road damage. Both axle-weight and congestion fees can be calculated with a high degree of precision, so that people will pay only for those demands they place on the system.

What roads should be tolled? According to ODOT, approxi-



CASCADE POLICY INSTITUTE
813 SW Alder, Suite 300
Portland, Oregon 97205
503·242·0900
fax·242·3822
www.CascadePolicy.org
Info@CascadePolicy.org

mately 61% of all miles traveled take place on about 17% of the existing lane-miles of roads in Oregon – mostly limited-access highways such as I-5 and I-84. These are the prime candidates for conversion to electronic tollways, because we would maximize the investment of the electronic tolling infrastructure. Such facilities should be supported solely by road user fees, and the fees should be set to cover the *actual* costs of road use. By limiting tolls to only those costs generated by each driver, we can prevent politicians from manipulating the toll rates for their own political gain.

## Spend toll revenue only on toll facilities

Once we switch to user fees on our most heavily traveled highways, the fee revenue needs to be restricted to the specific facility it was collected on. Allowing funds to be dumped into one big pot and distributed by formula or political appropriation virtually ensures large-scale waste. It also creates unfair income transfers. People should not be forced to subsidize facilities they don't use.

Toll revenues could be administered through regional highway bodies with locally-elected representatives, much as local Soil and Water Conservation Districts work. This would ensure that those who pay tolls would be the direct beneficiaries. By diminishing the role of ODOT, it would also eliminate funding bottlenecks in Salem that cause so many delays in road maintenance decisions.

For non-tolled roads, some residual state gas tax could be retained, or individual counties could enact local gas taxes to pay for road maintenance. A gas tax is not a true user fee, but it's close enough for roads that have too many intersections to be directly tolled.

## Abolish biennial registration taxes

Another concept that would improve administrative efficiency would be to abolish the biennial registration fee. Currently, the fee serves two purposes: it raises revenue, and provides the state with necessary information about vehicle ownership. Only the second function is important. Using the registration process to raise revenue is the wrong approach, because merely owning a vehicle does not impose costs on society. It's the actual *use* of the vehicle that creates costs, and that's where the focus of revenue collection should be. If we want to create the proper incentives, we should lower the *fixed* costs of vehicle ownership, and raise the *variable* costs. That would give motorists incentives to economize on their driving, because each driving decision would have meaningful financial consequences.

ODOT and state policing authorities have a legitimate need to know the names and addresses of vehicle owners, but that could be accomplished by requiring that owners simply register at the time of purchase and the time of any subsequent address change. The registration fee itself should be limited to the actual transaction costs of ODOT, and not be used as a profit center.

Elimination of the biennial fee would cut a large and costly part of the transportation bureaucracy, without any loss in road service.

## Privatize DMV

In addition, the entire DMV could be privatized -- an idea that was named one of the 10 winning entries in Cascade Policy Institute's 1996 *Better Government Competition*. Insurance companies, auto dealers and other institutions could be authorized to issue registration certificates, driver's licenses and license plates, which would decentralize the process and eliminate the dreaded trips to DMV offices. And because these private companies operate in competitive markets, the profit motive would create continual pressure for improved service and cost minimization.

An added benefit of this approach is that if organizations were held strictly liable for any accidents caused by vehicles they registered, they would have strong incentives for ensuring that all vehicles had safe drivers and adequate levels of liability insurance. This would help to reduce or eliminate the problem of uninsured motor vehicles.

## Ending the transit monopoly

In the transit arena, the legislature needs to accept that the 33-year experiment in government-run transit has failed. Since 1964, when the federal government first began subsidizing municipal transit operators, all levels of government have dumped billions of dollars of subsidies into inefficient public monopoly transit systems, and no relief is in sight. Governor Kitzhaber's proposal to increase the subsidies through a new utility tax would simply have worsenend the problem, because transit monopolies are subsidy junkies. They will always request more money because they have no incentive to be efficient.

Portland's Tri-Met is the most obvious example. Tri-Met has a monopoly on service, plus they get to collect a regional payroll tax from every employer in the region. This is the worst possible combination of policies. If you have a monopoly on subsidies and a monopoly on service, why worry about efficiency or innovation?

The lack of market discipline has allowed Tri-Met to make costly commitments to fixed rail transit that will never work. Light rail requires huge construction and operating subsidies, and cannibalizes bus service in the corridors it operates in, which actually makes customers worse off (buses are re-routed to become feeders for light rail, causing excessive delays). It also ties up agency resources in fixed routes at a time when society is rapidly decentralizing. This ensures that light rail will increasingly become irrelevant to the vast majority of the Portland regional population.

Despite its poor track record throughout the country, light rail continues to have the political support of most Portland elected officials because they are counting on someone else to pay the bill – through federal grants, state lottery funds, and federal gas tax receipts. But if rail were really such a good investment, it wouldn't need subsidies; it would be supported by its users. Market-based pricing on the west-side MAX line now under construction would reveal true costs of $15-75 per trip. It's highly doubtful that riders would actually be interested in paying such prices, but our monopoly system of transportation finance hides those costs.

Legislators wisely rejected the governor's utility tax, but they failed to do what could have solved the problem: legalize private sector transit to give consumers more choices. Where private buses, vans, and jitneys are legal in other parts of the country, they provide important services with far fewer costs, while still making a profit. The legislature should also phase out transit payroll taxes so that both highway and transit use are paid for directly by customers.

## Good policies already exist; where's the leadership?

The Oregon Transportation Plan, adopted 5 years ago, established a new policy for the state: transportation consumers should pay the full social costs of their use through direct user fees. That's exactly the right policy; now we just need political leaders to implement it. If Gov. Kitzhaber and legislative leaders are unwilling to do this, they should give up the idea of calling a special session. Doing nothing would be better than throwing more money into a system that is designed to fail.