Third, and most important, the trade-in program has demonstrated in a major way that a categorical funding program can be made more flexible and yet remain an effective and responsible source of federal financing. Funds have been used for the complete range of eligible projects--from rail transit and freeway construction, to bus fleet and bridge replacement, to transit station and local street rehabilitation. Often there have been delays in generating a list of proposed substitute projects, especially because a diverse set of governments and interests must reach a consensus without the benefit of rigid guidelines for using particular funds as prescribed by the federal government. But, on the other hand, there has rarely been any difficulty in generating matching shares for Interstate trade-in projects, which indicates the value of the program as viewed by its users. Overall, the trade-in experience demonstrates the potential success of future block grant mechanisms for federal urban transportation financing.

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Financing Local Roads in Indiana: A Status Report

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ABSTRACT

Indiana, like almost every other state, is slipping farther behind in the struggle to repair and maintain its deteriorating roads and streets. Just as the way in which this difficult situation developed in Indiana may differ from the details of other states' experiences, so might Indiana's efforts to cope with the problem. Many states raised motor fuels taxes in 1983 to supplement the funds made available by the 1982 Surface Transportation Assistance Act. However, only a portion of these road funds will be available at the county and city levels. Described in this paper are several programs recently introduced in Indiana that are specifically directed to road and street maintenance and repair at the local level. By reviewing these programs, seeing the degree to which they have been implemented, and examining the reasons for their less-than-universal use in Indiana, other states may be able to learn valuable lessons for devising their own techniques for generating revenue.

In 1959 the federal gasoline tax was set at 4 cents per gallon. During the next 23 years, the costs of building and maintaining roads increased considerably. Only the steady increase of automobile travel during the 1960s and early 1970s kept the Highway Trust Fund revenues on the rise as well. By the late 1970s automobile travel began to level off, and even decrease, which therefore caused a decrease in gallons of gasoline sold. After years of discussion and some false starts, the 1982 Surface Transportation Assistance Act (STAA) became law in January 1983. It replaced the 1978 STAA legislation by increasing the federal motor fuel tax to 9 cents per gallon, 1 cent of which was to be set aside for mass transit programs.

Since 1956 Indiana had been a donor state with regard to the Highway Trust Fund. Having completed most of its Interstate segments in the early years of that construction program, Indiana suffered the two-edged sword of the Highway Trust Fund allocation formula: (a) few uncompleted Interstate sections to attract federal funds and (b) an Interstate system of advancing age to maintain with the use of state funds. In recent years Indiana has ranked near the bottom in percentage of federal fuel tax revenues returned as federal highway assistance. In response to this problem, Indiana became one of the first states to structure its state motor fuels tax (MFT) on an ad valorem basis. The formula for the gasoline tax rate (GTR), in terms of the average pre-tax price (APTP) of all gasoline sold during the previous 6-month period (as of January 1 and July 1), is

$$\text{GTR} = 0.08\,(\text{APTP} - \$1.00) + \$0.10 \qquad (1)$$

rounded off to the nearest 1/10th cent, where

$$\text{APTP} = \text{Gross Sales} - (\text{State} + \text{Federal Taxes})/\text{No. of Gallons Sold} \qquad (2)$$

Because this formula was enacted in 1980, at a time when fuel prices were rising rapidly, the legislators placed a ceiling of 16 cents per gallon on the tax. Fortunately, they also saw fit in 1981 to make it a ratchet tax: the amount per gallon could never go down, only up. The tax reached a level of 11.1 cents per gallon in 1981 before reduced travel and more fuel-efficient cars caused a 7.7 percent decrease in fuel consumed in Indiana. Add price drops due to the oil glut and, without the ratchet, the tax would have fallen to 9.4 cents per gallon.

Even with the ratchet the Indiana Department of Highways (IDOH) has had insufficient funds to carry out a program that keeps pace with the deterioration of Indiana's roads and bridges. The state needs to resurface 1,000 centerline-miles of its 11,000-mile state highway system each year to keep up with the damage. But in recent fiscal years (FY), the following number of miles have been repaved: 494 in FY 1981, 533 in FY 1982, 288 in FY 1983, and 135 in FY 1984. If current projections for motor fuels and truck tax revenues are correct, the state will have only enough money from this source to repave 100 miles in FY 1985.

The 1982 STAA was good news for Indiana. The state had been receiving a return of only 65 percent of its contributions to the Highway Trust Fund as federal assistance under the old formula. The new act made the minimum return 85 percent. This, along with certain other measures, caused Indiana's allocation to more than double.

But the STAA fails to solve--and even inadvertently creates--some problems. For example, the new revenues cannot be used for the state highway system. In addition, no additional money was provided for the federal-aid secondary highway system. In Indiana these are general two-lane, low-volume roads extending into rural areas. These roads comprise 40 percent of federal highways in the state, and they, too, need resurfacing. The matching fund requirements of the STAA create an ironic problem for Indiana: unless the state can raise an additional $146 million in highway funds in the fiscal years 1984 and 1985, it could lose $212 million of its $457 million in federal allocations (1). In summer 1983 IDOH diverted almost $10 million from its 100 percent state-financed resurfacing program to help match federal-aid dollars. This meant that more than 100 miles of state highways did not receive the resurfacing work as scheduled. As of this writing, the Indiana General Assembly is considering a $55 million supplemental appropriation to enable IDOH to obtain the $242 million in federal highway aid for which Indiana is eligible in FY 1985 and to restore funds to the state resurfacing program.

Indiana's counties, cities, and towns face a similar problem. Their federal road and bridge funds have also doubled to more than $60 million per year. To use these funds, however, local governments will need to raise about $18 million per year in matching funds. Given the mixed blessing of the STAA in Indiana, and the state's barebones approach to its own highway system, the local governments would appear to have few places to turn for financial support. Several of the more interesting options available to cities and counties in Indiana are described in this paper.

THE LOCAL OPTION HIGHWAY USER TAXES

In 1980 the Indiana General Assembly passed legislation authorizing any county to adopt a local-option highway-user tax (LOHUT). LOHUT is actually two taxes that must be adopted at the same time:

1. A surtax of between 2 and 10 percent levied on the vehicle excise tax paid annually at the time of registration by owners of automobiles, motorcycles, and trucks lighter than 11,000 lb.
2. A wheel tax of between $5 and $40 per vehicle placed on all vehicles not subject to the excise surtax. The wheel tax vehicle categories are:

   - Buses (except church buses),
   - Recreational vehicles,
   - Semi-trailers,
   - Tractors,
   - Trailers, and
   - Trucks above the 11,000-lb class.

The vehicle excise tax is collected at the local level by branches of the State Bureau of Motor Vehicles. This money is transferred to a joint account from which the county treasurer may make withdrawals twice a year. Typically, this money is earmarked for parks, education, emergency services, and other nonhighway activities. Therefore, the LOHUT is designed to obtain some transportation-related use from funds generated by an annual local assessment on vehicles.

In 1981 only three of Indiana's 92 counties passed a LOHUT. These were among 10 counties eligible for a special distressed road fund (discussed next) if they passed a LOHUT. In 1982 only six more county councils took the same action. Most of the objections centered on the following problems:

1. The amount of revenue generated was insufficient to justify the politically risky act of passing a new tax in an era of tax limitation movements. Years before it became commonplace, Indiana established a ceiling on local property taxes that severely restricts the financial capability of local governments.
2. The revenues generated would be distributed to cities, towns, and counties on a road-mileage basis. Because cities and towns in Indiana have a population-to-mileage ratio seven times as large as areas under county jurisdiction, cities and towns opposed LOHUT. City and town residents would be paying more and getting less than county residents.
3. The wheel tax categories made no distinctions between heavy-duty industrial or farm trailers and light-weight, seldom-used boat trailers. At $5 the revenues generated would not be worth the political effort. At $40 the tax is clearly unfair to owners of light-trailers. The same problem occurred in choosing a fair tax for a single truck category that included vehicles with weight classes from 12,000 to more than 66,000 lb.

In 1982 three groups representing local government officials (the Indiana Association of Cities and Towns, the Association of Indiana Counties, and the Indiana Association of County commissioners) proposed revisions in the 1980 LOHUT Act that addressed the foregoing problems. After some revisions, the Indiana General Assembly:

1. Retained the excise surtax range at 2 to 10 percent, but established a minimum surtax amount at $7.50. Because the excise tax rate declines with vehicle age and many drivers are holding their cars longer, the $7.50 "floor" will generate nearly 50 percent more money.
2. Specified that LOHUT revenues shall be distributed according to the same local road and street account (LRSA) formula that is used to allocate some of the state's MFT revenues (see Figure 1). Applying statewide figures, the changes in allocations are given in Table 1.

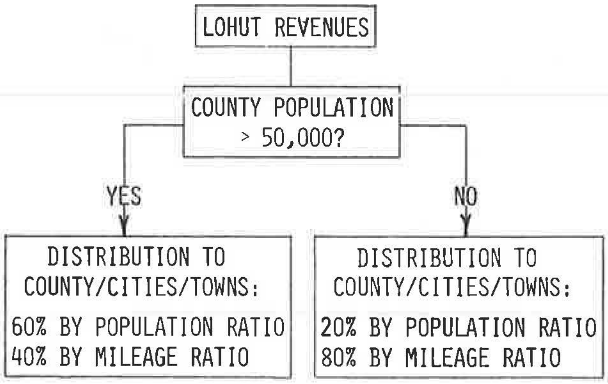

FIGURE 1 The local road and street account (LRSA) formula.

TABLE 1 Changes in LOHUT Revenue Distributions

	1980 LOHUT Act (%)	1983 LOHUT Revisions: County Population More Than 50,000 (%)	1983 LOHUT Revisions: County Population Less Than 50,000 (%)
County	83	57	74
Cities and towns	17	43	26

In the first year of this revised law, only four more counties have joined the LOHUT fold. Why so few? Following is a brief summary of the arguments in favor of and in opposition to a LOHUT.

Arguments Favoring LOHUT

1. The quality of some local roads has become intolerably poor, and no other remedy is available.
2. The most appropriate solution to local problems is local initiative.
3. If the problem is not serious enough for local public agencies to take some action, how can the state government be expected to acknowledge the need?
4. Taxing vehicle owners is a more equitable way to pay for the roads they use than appropriating general revenues raised through property taxes.
5. The money raised by a LOHUT remains in the local area. The existing license branches will, by law, collect the taxes with a fee of only 15 cents per vehicle. No money need be invested in a new bureaucracy or lost to a central clearinghouse.
6. All LOHUT revenues, unlike vehicle excise and motor-fuel tax collections, must be applied directly to construct, reconstruct, repair, or maintain local roads and streets.
7. LOHUT funds have a higher marginal value than existing funds. Because the wages, salaries, and overhead costs of a city or county highway department are already budgeted, any new funds from a LOHUT are allocated directly to road and street projects. In local public agencies where lack of funds causes underutilization of personnel and equipment, this is especially important.
8. The federal gasoline tax was 4 cents per gallon for more than 30 years. A $5 to $40 annual payment is a locally oriented, relatively inexpensive way of trying to catch up.

Arguments Against LOHUT

1. This new tax is not justified. Services can be cut elsewhere, or the cheaper of private contractors or in-house resources can be used, but no new taxes should be levied. (It should be pointed out, however, that Indiana law prohibits transfers of funds to and from highway accounts.)
2. The LOHUT concept is unfair because:

- It hurts people on fixed incomes.
- It is independent of vehicle use; an increase in the MFT would be more equitable.
- Because it is based on a county's vehicle registrations, a LOHUT taxes residents of that county, whereas drivers from non-LOHUT counties use the same (improved) roads without paying for them.
- It does not guarantee that a particular neighborhood road will receive attention. A tax based on the increase in road quality, assessed against the residents benefited and proportional to their frontage, would be more equitable. [Indiana law does contain a separate provision for "projects by assessment," but it does not apply to local government projects. There is a precedent, however, for citizens subsidizing county work on their roads (2).]
- Even under the improved allocation formula, drivers from cities and towns pay a higher percentage of LOHUT taxes as a group (approximately 60 percent statewide) than their governments will receive in revenues (see Table 1).

3. A county that passes a LOHUT will lose trucking, truck-related, and truck-dependent business (and their vehicle registrations) to non-LOHUT counties. A range of businesses from construction firms to dry cleaners make this point. Likewise, counties with universities whose students register their vehicles there may lose many registrations to the students' home counties. Because part of the state's MFT revenue distribution formula involves the number of vehicle registrations, any tax that drives away discretionary registrations can be counter productive.
4. An increased tax on trucks will drive up retail prices.
5. Cities and towns derive revenue from a county council decision, but lose the opportunity to decide how the next tax dollars (if any) are raised from its citizens.
6. There are too many roads; some serve only a few families, and some are maintained at too high a standard.

Each of these arguments, of course, has its own degree of validity. In most cases, the opposition has prevailed. But the increasing frequency with which LOHUT proposals are being discussed in public hearings and voted on by county councils indicates the relentless deterioration of local roads and the recognition that increased assistance from the state is an unlikely immediate solution.

SPECIAL FINANCING AUTHORITY

Ten counties in southwest Indiana have been provided special financing authority, because of severe deficiencies in their road systems. To increase the funding for road improvement projects, these counties may use (a) interest-free loans from a $10 million Distressed Road Fund or (b) bond issues for building and upgrading roads and bridges. To be eligible for either method, the county must first enact the LOHUT.

The Distressed Road Fund (DRF) was created in

1981 with $5 million in off-the-top deposits from MFT and special fuel tax receipts. In 1982 and 1983 $2.5 million per year was added to complete the fund. To date, 5 of the 10 counties have enacted a LOHUT, only 2 have received interest-free loans, but other counties are expected to apply soon.

With almost $9 million in the DRF and many counties unable to match federal funds made available by the STAA, the 1983 Indiana General Assembly created greater access to $5 million of the DRF. Local government units may now apply for interest-free loans if the unit

1. Is eligible to receive motor vehicle highway account (MVHA) funds, a portion of MFT allocations;
2. Certifies that it does not or will not have sufficient funds to meet the federal matching requirement; and
3. Agrees to allow the state auditor to divert its future MVHA distributions to repay the DRF directly if the unit fails to repay the loan within 2 years. This revision makes greater use of an existing fund at a time of great need and few alternative funding sources.

CUMULATIVE BRIDGE FUNDS

These funds are an important supplementary source of revenue for the construction, maintenance, and repair of bridges and grade separations. Since 1951 Indiana statutes have authorized county commissioners to establish a county-wide tax levy on all taxable personal and real property for the purpose of accumulating bridge construction and repair funds. More recently, maintenance activities became a legitimate use of the funds, and city councils and town boards were given the same authority. Funds are now available to conduct countywide bridge inspections and safety ratings--important elements in the federal-aid application process, in addition to their immediate role in maintenance management and public safety.

The annual tax levy may not exceed 30 cents per $100 assessed valuation. Each enactment may not be for more than 5 years duration, except for bridge leasing (discussed in the next section). The tax may be reduced or rescinded during this 5-year period. These tax receipts must be held in a special account, and, although the temptation has been great in recent months, they "shall not be expended for any [other] purpose" (3).

Currently, at least 82 of Indiana's 92 counties maintain a Cumulative Bridge Fund. Unfortunately, the need for bridge repairs is immense. Among the state's 11,129 off-system bridges, most of which are under county jurisdiction, are: (a) 3,668 that are restricted to light traffic, closed to all traffic, or in need of immediate repair to stay open and (b) 3,951 that can no longer safely serve their traffic loads because of out-moded design features. At the present rate, it will take more than 30 years to take care of the current backlog of substandard bridges (4).

LEASING OF BRIDGES

Although not strictly a revenue-generation technique, this provision of the 1971 Indiana Code gives county commissioners an option that may stretch county bridge funds. The commissioners "may enter into a contract of lease with any (profit or not-for-profit) corporation...duly admitted to do business in...Indiana" (5). Such a contract shall not extend longer than 15 years and must be supported by a petition signed by 50 taxpaying citizens of the county. The commissioners must then determine that a need exists for such a bridge. The county may not commit itself to leases exceeding the estimated annual revenue from a Cumulative Bridge Fund levy of 20 cents per $100 assessed valuation. In this case, the levy may be enacted for the length of the lease or 15 years, whichever is less.

Although this method has not been implemented in Indiana, there has been recent interest in the idea. It offers much the same features as the safe-harbor leasing provisions of the federal tax law used by many transit operators. The operators avoid the purchase price of new vehicles, while private corporations who are the eventual buyers also acquire the ability to claim tax advantages from the equipment as it depreciates. In a similar way, counties could avoid or pass on the high cost of bridge construction or replacement in exchange for a mutually beneficial long-term lease agreement.

CONCLUSIONS

Indiana's road and bridge problems are typical of those in most states, especially at the local level. But provisions have been made for Indiana counties and municipalities to generate funds to replace, match, or supplement assistance from the state and federal governments. As the list of arguments for and against a local option highway user tax indicated, there are no obvious solutions to the problem of revenue generation. The self-reliant, home rule philosophy so many Hoosiers ascribe to must be balanced against the availability of more federal assistance. The project categories for which these federal dollars are specified must be compared with the greatest needs of the local transportation network. It is a matter of philosophy and a question of trade-offs. At least the local public agencies in Indiana have a number of useful options at their disposal. Their experiences can be instructive to other states seeking innovative responses to the road and bridge revenue shortfall.

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