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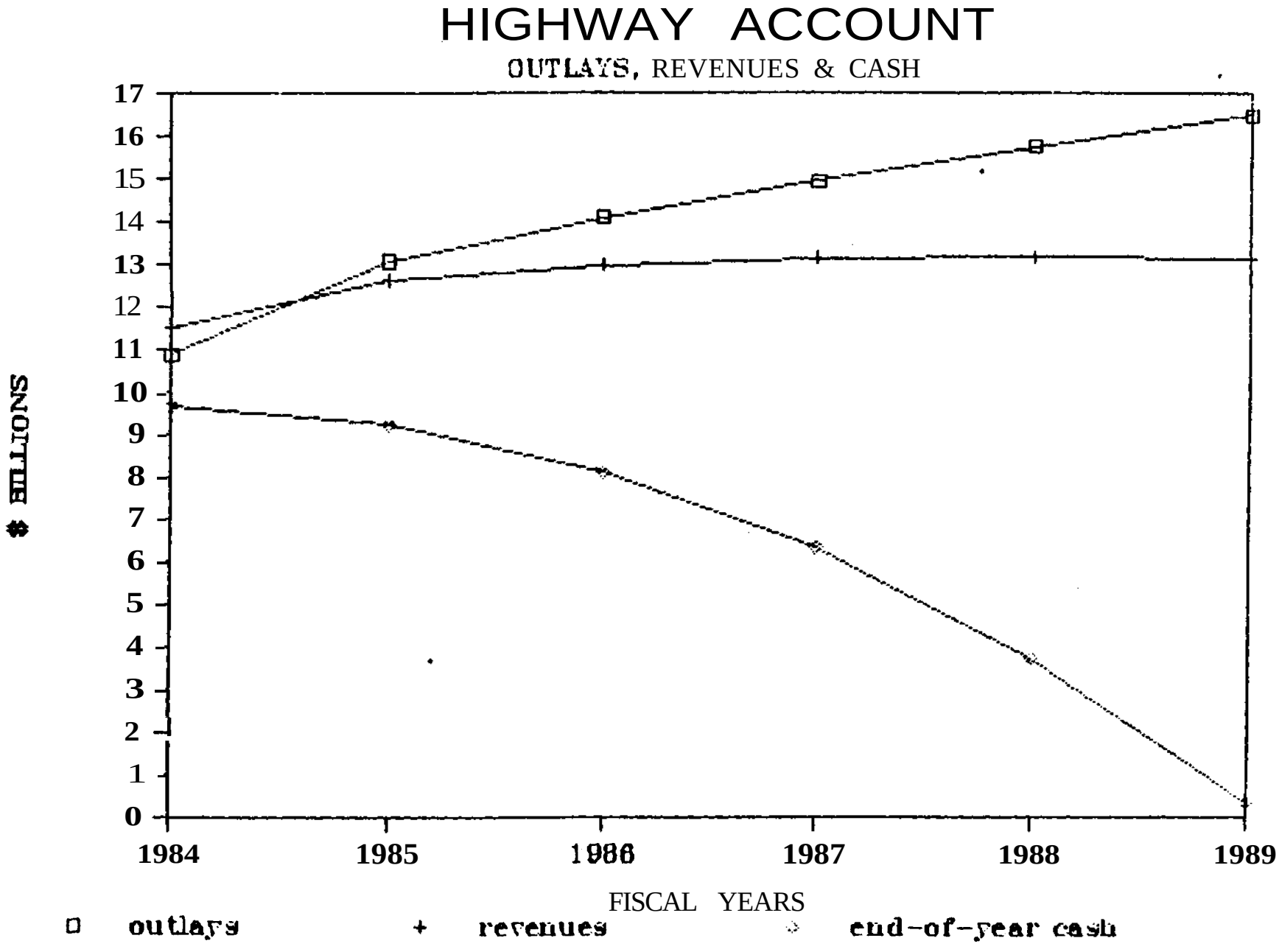
Mr. Chairman, I am pleased to appear before your Subcommittee to discuss the financial condition of the Highway Trust Fund and its implications for the current federal highway program. In passing the Surface Transportation Assistance Act of 1982, the Congress made considerable progress in realigning the federal highway program with the most pressing current needs--the maintenance and repair of the nation's highway system. At the same time, however, the increased authorizations in the 1982 legislation were not entirely accommodated by the increased taxes. As a result, the cash balance in the trust fund's Highway Account is being eroded and by 1989 would be essentially eliminated. (The Congressional Budget Office's projection is displayed in Figure 1). Thus, the Congress faces difficult choices in striking a balance between increased highway revenues and decreased spending. My testimony today concerns options that the Congress might consider in achieving the desired balance.

THE HIGHWAY PROGRAM AND HIGHWAY NEEDS

The rationale underlying federal involvement in highways rests with the need for a coordinated national road network to facilitate commerce and national defense. Though some parts of this network have proven able to support themselves as toll roads, the system as a whole still requires government support. Indeed, the federal financial commitment to highways

FIGURE I


HIGHWAY ACCOUNT
OUTLAYS, REVENUES & CASH
$ BILLIONS
17
16
15
14
13
12
11
10
9
8
7
6
5
4
3
2
1
0
1984
1985
1986
1987
1988
1989
FISCAL YEARS
outlays
revenues
end-of-year cash

has grown to account for about one-third of highway spending by all levels of government.

As the Congress recognized in passing the 1982 highway act, the most pressing highway need is to keep the existing roads in an adequate state of repair. This is particularly important for those roads of greatest importance to the economy--the Interstate Highway System. Though accounting for only 1 percent of all route-miles, the Interstate carries 20 percent of the nation's traffic, including half of all combination trucks. Virtually none of this mileage was in poor repair in 1972, but conditions have recently worsened as many roads and bridges passed their design lives without adequate maintenance. Department of Transportation (DOT) estimates show that, by 1981, more than 8 percent of the Interstate System was in poor condition.

From both a private and a public perspective, keeping roads in good repair is critical. As conditions worsen, overall transportation costs increase markedly. To highway users, vehicle maintenance costs rise as roads become rougher, as slower speeds and detours lengthen travel times, and as accidents become more numerous. Vehicle operating costs on a deteriorated road may range from 15 percent to 30 percent higher than the costs of using a road in good condition. Declining road quality also drives up public costs. The rate of road deterioration accelerates if needed repairs

are not made, and in fact, about three-quarters of pavement deterioration occurs in the last two or three years of a road's design life. As a result, the long-run cost to the government tends to increase as repairs are postponed.

The large increase in authorizations passed in 1982 should improve conditions on the Interstate System and maintain the rest of the Federal-Aid System at least in its current condition. Of the new construction that remains, the most important part--completion of the last 4 percent of the Interstate System--should be finished by the early 1990s. Because of continuing repair needs, however, it appears unlikely that achieving this goal would permit any sizable reduction in highway spending.

Thus, the nation's highway needs continue to shift toward maintenance and repair. At the same time, the drawdown of cash in the trust fund raises concerns about its proper financial management.

FINANCIAL MANAGEMENT OF THE HIGHWAY TRUST FUND

The Highway Trust Fund was created to provide a stable, long-term source of financing for the federal highway program. Three general principles ensure the financial soundness of such a fund:

- First, cash on hand should cover expected outlays during any given year;

- Second, cash on hand plus future receipts should cover promised spending; and

- Third, outlays and receipts must balance in the long term.

The most important financial control for the Highway Account is contained in the Byrd Amendment, which has been in effect since establishment of the Highway Trust Fund in 1956. The Byrd Amendment focuses on unfunded authorizations--that is, total unpaid authorizations less any cash on hand. The amendment forces an automatic reduction in funds available to the states if the unfunded authorizations exceed expected revenues over the remaining life of the fund. At present, the taxes that support the Highway Account expire in 1988, while 1986 is the last year of full authorization. Thus, current policy implies that unfunded authorizations should not exceed two years' worth of revenues.

The Highway Account

Highway users finance the federal highway program according to the accepted principle that the system's users--rather than the general

taxpayer--should support its construction and repair. The 1982 act established four federal highway taxes:

- o a 9 cent per gallon tax on motor fuel;
- o a 12 percent sales tax on new trucks over 33,000 pounds and trailers over 26,000 pounds;
- o a graduated tax on truck tires; and
- o a graduated use tax on heavy-vehicles

The fuel tax accounts for almost 80 percent of the $11.6 billion expected to be raised in 1985 for highways. The 1982 act reduced some truck taxes, but the heavy-vehicle use tax was increased dramatically, from the previous maximum of $240 per truck to a maximum of $1,900 per year for trucks at the federal weight limit of 80,000 pounds. This increase is being phased in over four years, with the biggest increase--to $1,600--scheduled to take effect this July. The 1982 act also provides economic benefits to some truckers by permitting the use of wider, heavier, and longer trucks on major intercity routes.

Altogether, the 1982 legislation raised annual receipts for the highway program from $6.7 billion in 1982 to an estimated $11.6 billion in 1985. With interest on the cash balance added, annual receipts should total about $12.6 billion. At the same time, however, annual authorizations were increased to $14.9 billion in 1985--about $2.3 billion more than expected receipts. Clearly, such a gap cannot be sustained for long.

Indeed, the trust fund can only finance the 1982 authorizations because of the cushion provided by the $9 billion in cash built up in prior years, and because of the normal lag between authorizations and outlays. Under current policy, the criterion of unpaid authorizations' not exceeding two years' worth of revenues would be violated in 1988 (for details, see attached Table 1). By 1989, the cash balance would drop well below the $2 to $3 billion needed to meet normal cash flow requirements.

Of course these projections are subject to the usual uncertainties in predicting tax receipts, outlays, and interest rates. Nevertheless, the need for action to restore balance to the Highway Account seems clear. The magnitude of this action, however, depends in large part on the level of future authorizations enacted by the Congress. If authorizations after 1986 were increased only to keep pace with inflation, about $2 billion a year in additional revenues would suffice. However, any increase in authorizations above current levels, or any expansion of current tax exemptions, would require a larger tax change. On the other hand, if total authorizations were to drop in 1991, when the Interstate system is scheduled to be completed, the prospect of reduced spending would permit a smaller increase in receipts.

Highway Revenue Options

A number of options are available for increasing revenues. For example, an additional 2 cents per gallon tax on motor fuel starting in 1987 would, by itself, raise the roughly $2.3 billion a year needed to support the current program. Such a change, however, would shift the tax burden toward passenger cars--a group that the DOT has found to pay more than its share of federal costs already. 1/ Thus, other approaches might be used to complement a simple motor fuels tax. For example, trucks weighing more than 75,000 pounds are estimated to pay only about two-thirds of their share of federal costs. Thus, another option would be higher taxes for these vehicles. The potential gain in revenues would be about $600 million a year.

A third way to supplement a general highway revenue increase would be to reduce the existing tax exemptions for buses and taxis, state and local government vehicles, and producers of gasohol. These tax subsidies reduce trust fund revenues by more than $700 million a year, and they appear to have few economic justifications. All vehicles, whether publicly or

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1. See Department of Transportation, Final Report on the Federal Highway Cost Allocation Study (May 1982). The DOT study allocated federal highway expenditures among each class of vehicle according to the relative damage each caused to the highway network. However, to the extent that maintenance needs are not fully funded, allocating costs based solely on expenditure may understate the relative damage caused by each vehicle class.

privately owned, cause wear and tear on the nation's roads, and the subsidy to gasohol producers appears excessive in light of that fuel's modest contribution to U.S. energy independence.

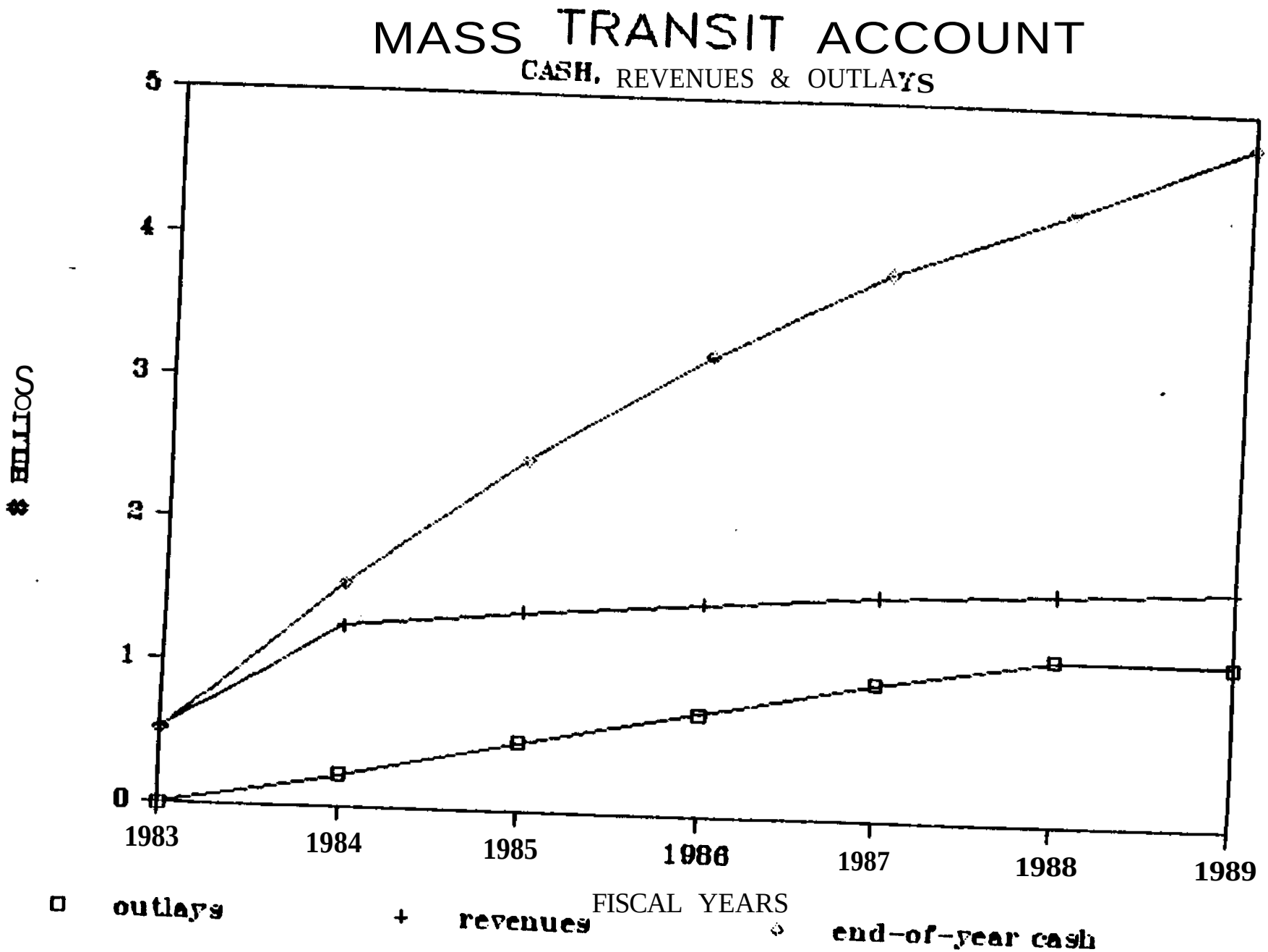
A fourth option would use surplus funds from the Mass Transit Account. Revenues from one cent of the motor fuel tax are adequate to finance existing authorizations, and interest on the cash balance in the account adds another $400 million a year (see Figure 2). These interest earnings are not required to finance the transit authorizations and could be transferred to the Highway Account.

In addition to revenue options, spending changes could also be considered in the context of the current highway program.

IMPLICATIONS FOR THE HIGHWAY PROGRAM

The 1982 act represents landmark legislation, providing the largest increase in federal highway resources in a quarter of a century. By channeling most of these increases into repair and modernization, the Congress helped to shift the emphasis of the program away from new construction and toward the maintenance of existing highways. As a result, the money available for Interstate modernization totals $2.8 billion in

FIGURE 2


MASS TRANSIT ACCOUNT
CASH, REVENUES & OUTLAYS
$ MILLIONS
5
4
3
2
1
0
1983
1984
1985
1986
1987
1988
1989
FISCAL YEARS
outlays
revenues
end-of-year cash

1985--three and one-half times the 1982 level. Similarly, funds for bridge repair exceed $1.7 billion, nearly twice the level of 1982. Of total federal highway outlays of $13 billion, more than half now goes for repair, resurfacing, and restoration--rather than toward adding new roads.

Possible Program Modifications

Though the Highway Trust Fund faces no immediate danger of bankruptcy, its condition does raise warning signals about any actions that might increase spending or decrease revenues. For example, a 5 percent increase in the level of authorizations--about $750 million a year--would be enough to drive unfunded authorizations above two years' worth of revenues in 1987, one year sooner than under current policy.

Similarly, proposals to increase tax expenditures, such as the exemption for gasohol, should be weighed carefully. At present, gasohol is exempt from 5 cents of the 9 cent per gallon federal tax on motor fuel. Because ethanol (a grain derivative) makes up only 10 percent of gasohol, this exemption provides a 50 cent per gallon subsidy to producers of ethanol. This provision reduces receipts to the Highway Account by about $200 million a year. If this subsidy were increased to 90 cents per gallon, the revenue loss would be more than proportionate.

Even greater revenue losses would occur under some of the current proposals to substitute a higher tax on diesel fuel used by trucks for the existing heavy-vehicle use tax. The two most prominent proposals, S. 1475 and its House counterpart, H.R. 2124, would increase by 5 cents the current 9 cent per gallon federal tax on diesel fuel, while giving vehicles weighing less than 10,000 pounds access to a tax rebate. On balance, the DOT estimates that tax receipts would decline by about $2 billion over the next four years. As shown in Figure 3, this change from current policy would generate a $3 billion deficit in the Highway Account for 1989 (see attached Table 2). These twin bills would move heavy trucks further below their cost-based share of federal highway taxes, while increasing the amount by which light trucks overpay. For example, combination trucks over 75,000 pounds would pay only 58 percent of their share of costs, in contrast to the current 66 percent (see attached Table 3).

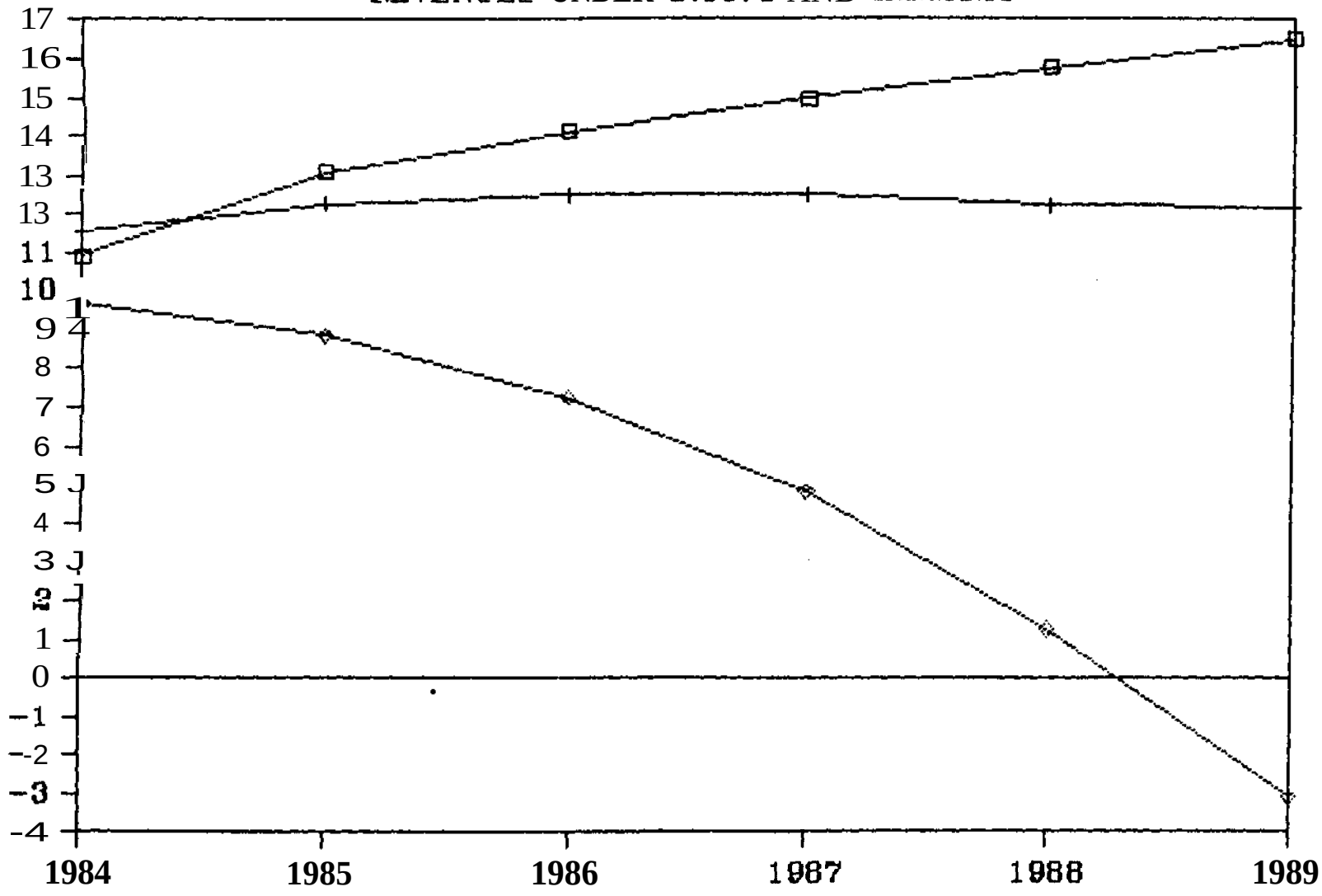
Though the current federal commitment is roughly in line with the needs for highway infrastructure, some savings could be made by deferring certain work for a few years. 2/ For example, large sums continue to be devoted to construction of new Interstate highways, even though less than half of the remaining construction cost is related to the highest federal priority--an interconnected system of intercity roads. If construction were

2. See Congressional Budget Office, Public Works Infrastructure; Policy Considerations for the 1980s (April, 1983).

FIGURE 3

HIGHWAY ACCOUNT

REVENUES UNDER S.1475 AND H.R.2124



deferred until after 1990 on local roads that are less essential to an interconnected system--primarily urban segments--the current $4 billion spent each year on Interstate construction could be cut by half. Such a change would permit the highway program to continue its emphasis on repair of existing roads, while deferring the need to raise highway taxes until after 1990.

CONCLUSIONS

In conclusion, Mr. Chairman, the pending shortfall in the Highway Account is clearly the most important problem affecting the highway program since passage of the 1982 act. Though this problem could be deferred until the next major highway authorization--presumably in 1986--the Congress will, at some point, face important decisions regarding raising taxes, reducing the highway program, or striking an appropriate balance between the two courses. These decisions afford an opportunity to continue the shift in emphasis toward needed maintenance and repair, and to correct current imbalances in the support of the system by its diverse classes of users.

TABLE 1. FINANCIAL PROJECTIONS FOR THE HIGHWAY ACCOUNT OF THE HIGHWAY TRUST FUND
(In millions of dollars)

Fiscal Year	Highway Authorizations	Outlays	Trust Fund Income	Start-of-Year Cash Balance	Change	End-of-Year Cash Balance	Unfunded Authorizations
		a/	b/				
1984	14,120	10,900	11,510	9,060	+610	9,670	16,710
1985	14,860	13,080	12,630	9,670	-450	9,230	18,940
1986	15,660	14,100	13,000	9,230	-1,100	8,130	21,590
1987	16,320 c/	14,950	13,160	8,130	-1,790	6,340	24,760
1988	16,980 c/	15,760	13,180	6,340	-2,580	3,760	28,560
1989	17,630 c/	16,520	13,130	3,760	-3,390	360	33,060

SOURCE: Congressional Budget Office.

NOTE: Details may not add to totals because of rounding.

a. Outlays based on obligation ceilings which are less than authorizations. Level of outlays also depends on when Interstate construction funds for 1984 are released.

b. Treasury forecast of tax receipts with CBO interest rate assumptions.

c. CBO current policy projections.

TABLE 2. FINANCIAL PROJECTIONS FOR THE HIGHWAY ACCOUNT OF THE HIGHWAY TRUST FUND UNDER S. 1475 AND H.R. 2124 (In millions of dollars)

Fiscal Year	Highway Authorizations	Outlays	Trust Fund Income	Start-of-Year Cash Balance	Change	End-of-Year Cash Balance	Unfunded Authorizations
			a/	b/			
1984	14,120	10,900	11,510	9,060	+610	9,670	16,710
1985	14,860	13,080	12,260	9,670	-820	8,850	19,310
1986	15,660	14,100	12,480	8,850	-1,620	7,240	22,490
1987	16,320 c/	14,950	12,500	7,240	-2,450	4,790	26,310
1988	16,980 c/	15,760	12,230	4,790	-3,540	1,250	31,070
1989	17,630 c/	16,520	12,170	1,250	-4,350	3,100	36,520

SOURCE: Congressional Budget Office.

NOTE: Details may not add to totals because of rounding.

a. Outlays based on obligation ceilings, which are less than authorizations. Level of outlays also depends on when Interstate construction funds for 1984 are released.

b. DOT forecast of tax receipts with CBO interest rate assumptions.

c. CBO current policy projections.

TABLE 3. REVENUE-TO-COST RATIOS FOR 1985 UNDER DIFFERENT TAX SCHEMES

Vehicle Class	Under Pre-1982 Law	Under Current Law	Under S. 1475 and H.R. 2124
Passenger Cars and Motorcycles	0.97	1.06	1.09
Buses	0.0	0.0	0.0
Pickups/Vans	1.17	1.18	1.21
Single-Unit Trucks	1.76	1.14	1.19
Under 26,000 pounds	(1.38)	(1.12)	(1.21)
Over 26,000 pounds	(2.07)	(1.16)	(1.17)
Combination Trucks	0.80	0.82	0.74
Under 50,000 pounds	(1.21)	(0.90)	(1.02)
50-70,000 pounds	(1.22)	(1.20)	(1.07)
70-75,000 pounds	(0.78)	(0.84)	(0.76)
Over 75,000 pounds	(0.59)	(0.66)	(0.58)
All Vehicles	1.00	1.00	1.00

SOURCE: Congressional Budget Office from analysis by the Department of Transportation.

NOTES: A number greater than 1 represents overpayments, while a lesser number shows underpayments. Numbers in parentheses are subtotals.