Statement of
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before the
Subcommittee on Transportation
Committee on Environment and Public Works
United States Senate

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Mr. Chairman, I am pleased to appear before this 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 toward meeting the most urgent highway needs--those of maintenance and repair. At the same time, however, the 1982 legislation increased authorizations by some $2 billion to $3 billion a year more than the increase in taxes. As a result, the cash in the trust fund's Highway Account is being eroded and by 1990 will be eliminated if current trends continue.

My testimony today focuses on some of the options for restoring long-term financial stability to the highway program. These options include changes in spending, changes in revenues, and alternative means of financing roads such as the greater use of toll roads.

FINANCIAL MANAGEMENT OF THE HIGHWAY TRUST FUND

The Highway Trust Fund was created to provide a stable, long-term source of user-based financing for the federal highway program. To ensure the financial soundness of the fund, the cash available should cover expected outlays during any given year. Moreover, outlays and receipts must balance in the long term. The most recent major highway legislation was the 1982

act, which increased the federal tax on motor fuel by five cents per gallon to nine cents per gallon, with receipts from one cent of the tax dedicated to mass transit.

Altogether, the 1982 legislation raised annual receipts for the highway program by almost $5 billion. With interest on the cash balance added, receipts should total about $13.4 billion in 1986. At the same time, however, annual authorizations were increased to $15.5 billion in 1986--about $2.1 billion more than expected receipts. Clearly, such a gap cannot be sustained. Indeed, because revenues from the motor fuel tax are expected to grow at only 1 percent to 2 percent a year, this gap will widen if authorizations are increased to maintain today's purchasing power. (Table 1 summarizes this current policy projection for the fund over the next several years.)

The trust fund can finance current authorizations only because of the cushion provided by the cash built up in prior years (totaling $10.5 billion in 1985), and because of the normal lag between authorizations and outlays. By 1989, the cash balance will drop to $3 billion, the minimum needed to meet normal cash flow requirements. (See bottom line in Figure 1.) 1/

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1. The Byrd Amendment criterion of unfunded authorizations not exceeding two years' worth of revenues would be violated in 1989.

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

Fiscal Year	Authorizations a/	Outlays	Income b/	Start of Year Cash Balance	Change	End of Year Cash Balance	Unfunded Authorizations
1985	15,100	12,850	13,200	10,200	350	10,550	18,300
1986	15,500	14,150	13,450	10,550	(700)	9,850	20,350
1987	16,050	15,000	13,500	9,850	(1,500)	8,400	22,850
1988	16,550	15,750	13,500	8,400	(2,250)	6,150	25,900
1989	17,100	16,450	13,450	6,150	(3,000)	3,100	29,600
1990	17,800	17,100	13,400	3,100	(3,700)	(600)	34,000

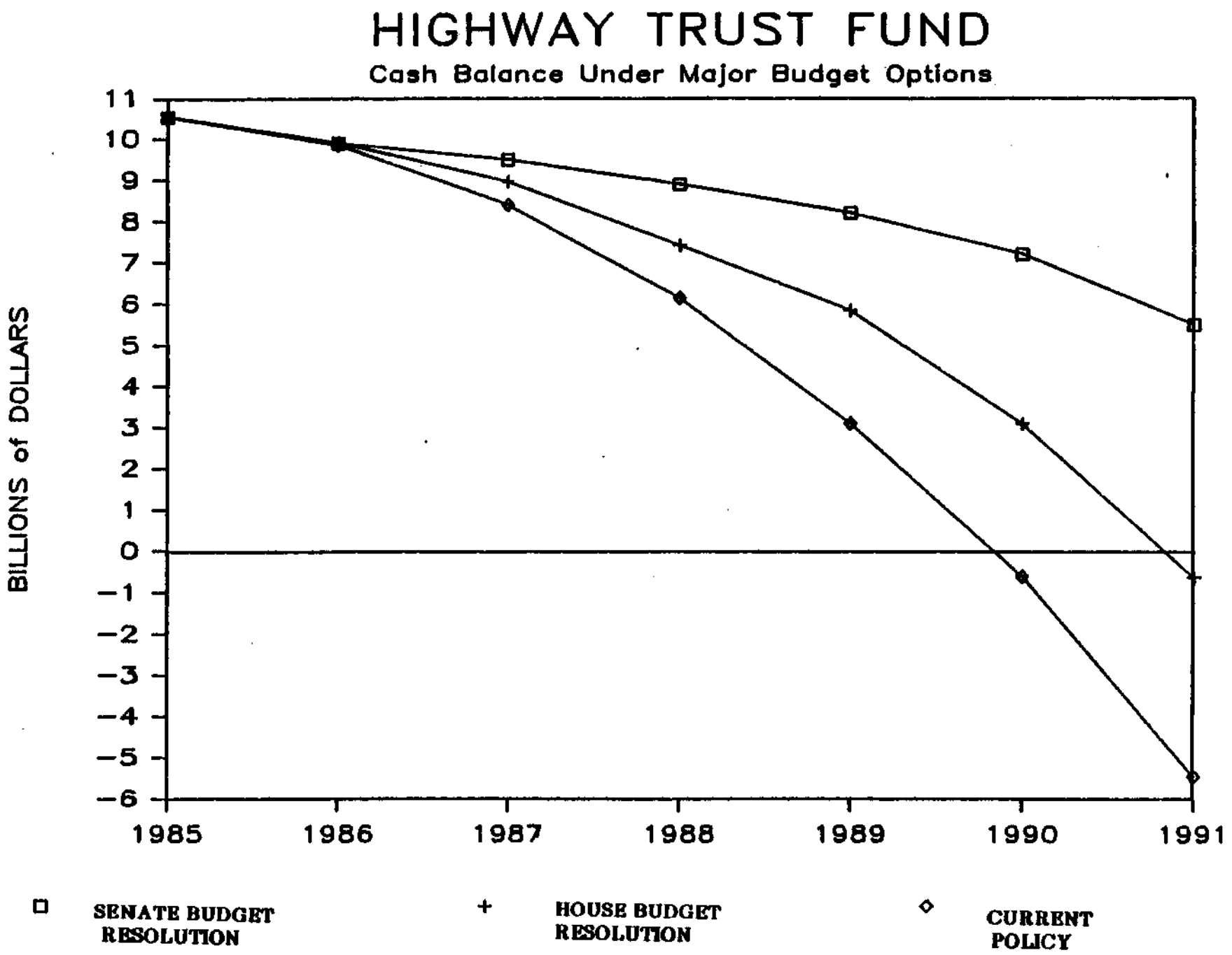
SOURCE: Congressional Budget Office.

NOTE: Totals may not add due to rounding. Parentheses denote negative numbers.

a. Authorizations and outlays are based on current law through 1986, and adjusted for inflation in 1987-1990.

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

Figure 1


HIGHWAY TRUST FUND
Cash Balance Under Major Budget Options
BILLIONS of DOLLARS
11
10
9
8
7
6
5
4
3
2
1
0
−1
−2
−3
−4
−5
−6
1985
1986
1987
1988
1989
1990
1991
SENATE BUDGET RESOLUTION
HOUSE BUDGET RESOLUTION
CURRENT POLICY

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. Strategies for restoring this balance include: revenue changes, spending changes, and greater use of toll roads. Figure 2 summarizes some of the specific options that I will discuss.

Revenue Options

Revenues could be increased in a number of different ways. For example, an additional two cents per gallon tax on motor fuel would, by itself, raise the roughly $2.1 billion a year needed to support the current program. Since automobiles consume the bulk of motor fuel, such a change would shift the tax burden toward owners of passenger cars--a group that already pays its estimated share of the costs that it imposes on federal highways through the nine cents per gallon tax on motor fuel. Thus, another approach might be to raise taxes for those vehicle groups whose excise tax payments are less than the costs that they impose. Heavy trucks are the largest of these groups. The Department of Transportation estimates, for example, that trucks weighing more than 75,000 pounds pay only about two-thirds of their share of federal costs. 2/ Therefore, a second option would

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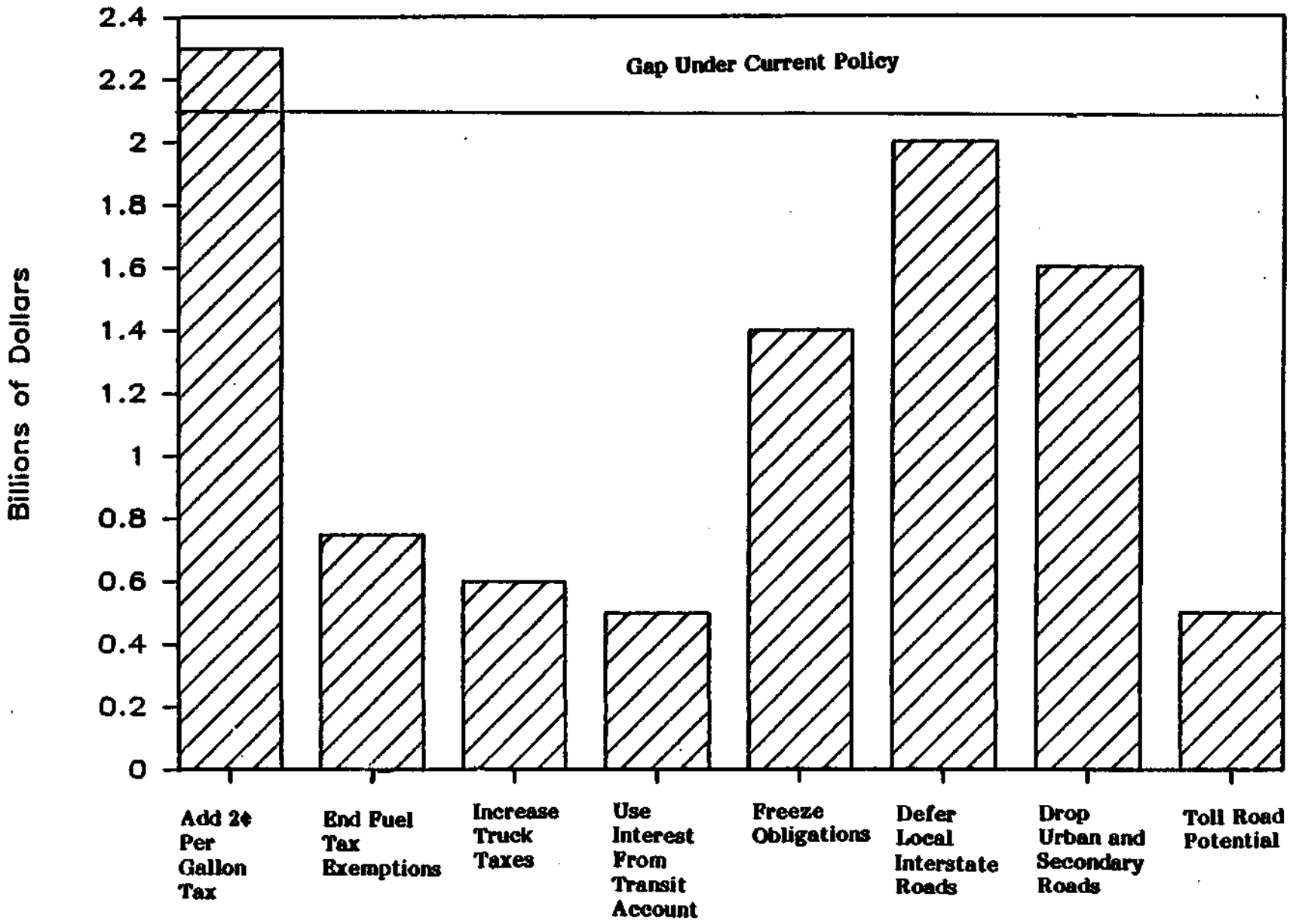
2. From data compiled by the Federal Highway Administration for Final Report on the Federal Highway Cost allocation Study (May 1982).

Figure 2

SELECTED OPTIONS FOR CLOSING GAP BETWEEN HIGHWAY TRUST FUND OUTLAYS AND REVENUES



be higher taxes for these vehicles. One possibility for such a truck tax is a federal weight distance tax, similar to existing state weight distance taxes. The potential gain in revenues from such a tax would be about $600 million a year, by itself not enough to close the entire gap between outlays and receipts.

A third way to supplement highway revenues would be to eliminate the existing tax exemptions for buses, state and local government vehicles, and producers of gasohol. These tax subsidies reduce trust fund revenues by more than $700 million a year, and their economic justification is often questioned. Whether publicly or privately owned, all vehicles cause wear and tear on the nation's roads, and the 60 cents per gallon federal subsidy to gasohol producers should be contrasted to that fuel's modest contribution to U.S. energy independence. 3/

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 $500 million a year. These interest earnings are not

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3. Gasohol consists of 90 percent gasoline and 10 percent ethanol. While ethanol is made from agricultural commodities and not petroleum, it does require substantial amounts of energy to produce. At present, imports (mostly from Brazil) account for a large fraction of U.S. consumption of ethanol.

required to finance current transit authorizations from the trust fund and could be transferred to the Highway Account. This option would, however, foreclose an increase in transit spending from the trust fund. Unlike the other options I discuss, shifting funds from the mass transit account would have no effect on the overall budget deficit, even though it would help improve the Highway Trust Fund.

Spending Options

Spending restraint is another option for restoring balance to the Highway Trust Fund. The Senate Budget Resolution calls for holding highway obligations for 1986 at $12.75 billion, or some $2.5 billion below the authorized level. Obligations would then be increased to $13.25 billion for 1987 and 1988. The Highway Trust Fund could remain solvent through the early 1990s if obligations in 1989 and beyond were increased only for inflation. (See top line in Figure 1.) The House Budget Resolution is less restrictive than the Senate proposal, calling for a freeze in 1986 with obligations at $13.75 billion. Since obligations would then be maintained at the same real level, the cash balance would be eliminated in 1991.

Obligation ceilings, however, effectively transfer control over program priorities from the federal government to state highway

departments. For example, an obligation ceiling of $12.75 billion means that the states, rather than the federal government, choose how to allocate $2.5 billion in program cuts among various highway programs: completion of the Interstate, bridges, road repair, and so forth. Similar reductions could be achieved by enacting specific program changes at the federal level, thereby reducing highway spending while still assuring that the highest federal priorities were met.

The largest new construction component of the federal program is the $4 billion a year devoted to completing the last 1,500 miles of the Interstate System. Less than half the remaining $23 billion in construction costs concerns a connected system of intercity roads. If construction were deferred until after 1990 on roads that provide mostly local economic benefits--primarily segments in urban areas--the current $4 billion spent each year on Interstate construction could be cut by half. [4/] Such a change would permit the highway program to continue its emphasis on repairing existing roads, while deferring the need to raise highway taxes until after 1990.

Similarly, the federal government spends nearly $2 billion a year on the repair and construction of urban and secondary roads that serve primarily local interests and on roads and bridges that are not part of the

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4. Congressional Budget Office, The Interstate Highway System: Issues and Options (April 1982).

federal road system. Complete responsibility for these roads could be turned back to state and local governments so that federal dollars could be concentrated on roads of greatest national priority. While this would impose greater financial burdens on state and local governments, the costs may be somewhat less expensive since states would be free to set their own engineering and labor regulations.

Toll Roads

Toll roads are another financial option, one that CBO has analyzed in depth at the request of your Subcommittee. I will summarize our results, emphasizing the special advantages and disadvantages of toll roads.

Toll roads and bridges have always played a role in the nation's highway network. Since its start in 1916, however, the federal highway program has been dedicated to free roads. With only a few exceptions, federal highway funds cannot be used to help build toll facilities.

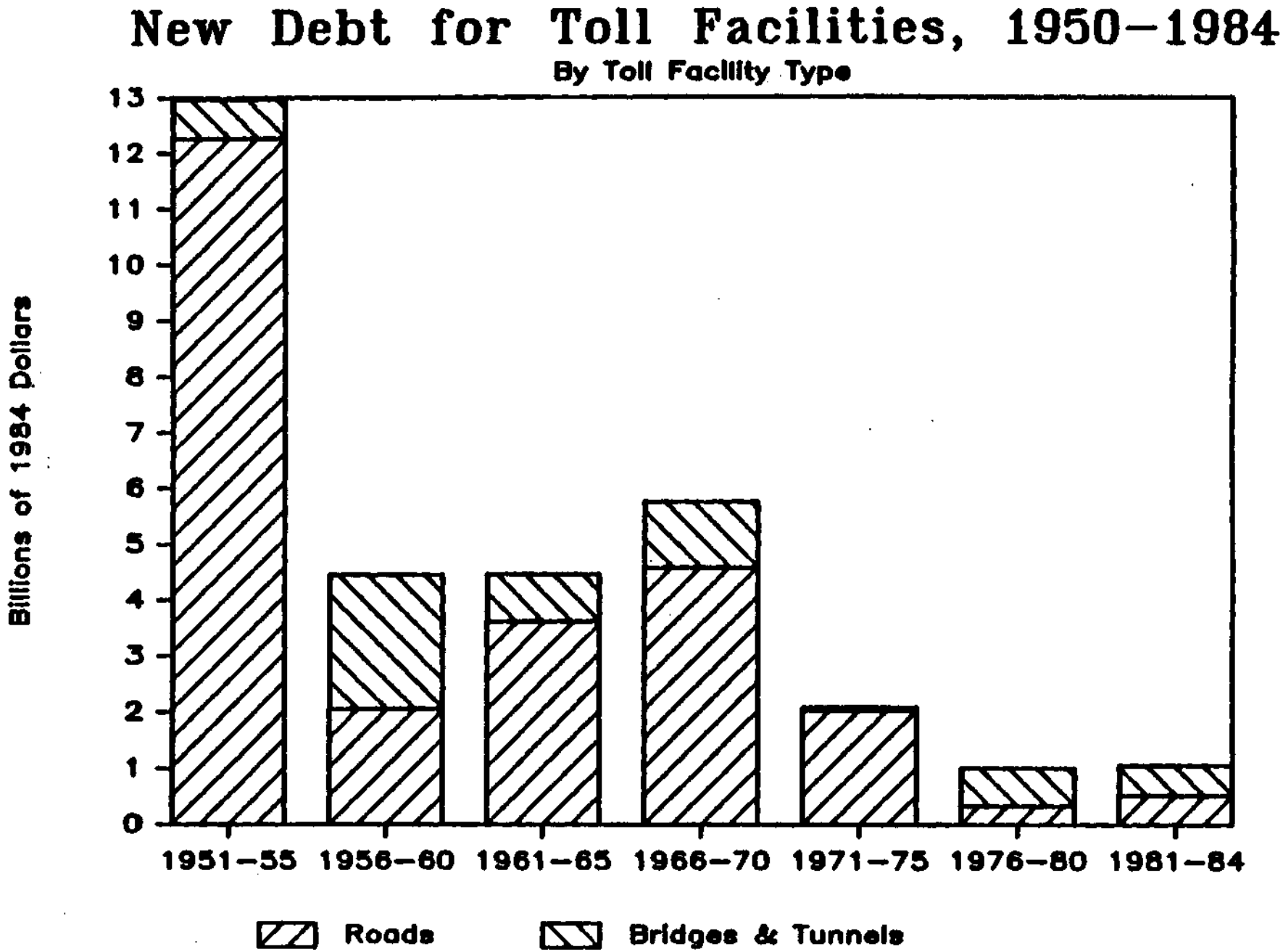
There are more than 5,000 miles of toll roads in the nation today, mostly built before the start of the Interstate System in 1956. This includes

2,691 miles, or about 6 percent of the Interstate System. Toll facilities historically have fared well in the bond market, with most toll road bonds receiving investment grade ratings. Despite this success, construction of new toll roads has nearly ended. Figure 3 shows that most recent bond issues have been for bridges or tunnels, with toll road construction down to only about 5 percent of its level before the start of the Interstate System. This sharp decline has occurred for three reasons:

- The existence of a network of good, free roads that compete with new toll roads;
- Much higher road construction costs than during the 1950s and 1960s; and
- Historically high interest rates for tax exempt bonds.

Because of high construction and financing costs, our analysis shows that a typical urban toll road requires traffic of between 100,000 and 200,000 vehicles a day to be financially self-supporting. In 1983, only about 3 percent of the Interstate System was this heavily travelled. Thus, there are relatively few places in the country where new toll roads can be built without some form of government subsidy. The financial feasibility of the Dulles Toll Road, for example, depends on federal land provided under an inexpensive lease to the State of Virginia. As a result, the number of new toll roads being built is likely to increase only if there is either a significant drop in costs--perhaps through a major decline in interest rates--or if

Figure 3


New Debt for Toll Facilities, 1950–1984
By Toll Facility Type
Billions of 1984 Dollars
0
1
2
3
4
5
6
7
8
9
10
11
12
13
1951–55
1956–60
1961–65
1966–70
1971–75
1976–80
1981–84
Roads
Bridges & Tunnels

federal policy changes and funds are provided to help subsidize the construction of toll roads.

Interest in changing federal restrictions on the use of federal funds for toll roads has been spurred by the financial pressures on the Highway Trust Fund and by the concentration of federal and state highway funds on maintaining the existing network. Today, roughly 60 percent of the federal highway program is spent on repair and modernization, the areas of greatest national highway need. Another 30 percent of the program is dedicated to completing the remaining few miles of the Interstate System. As a result, only about 10 percent of the program's funds is available to help states and localities add new capacity to their own networks. This poses a particular problem in suburban areas and in fast-growing parts of the country.

Any consideration of toll roads involves some key trade-offs. Specifically, does the higher level of service that is generally possible on toll roads justify the inconvenience to the traveler and the additional administrative costs of a toll facility? About 14 cents of every toll dollar is used for collection costs alone. This amount is about double the collection costs for the typical package of state highway taxes and roughly 10 times the cost of collecting the excise tax on motor fuel. Toll roads also require additional capital costs to construct toll plazas and some toll roads spend more on maintenance than do free roads.

Although tolls are generally a less efficient means to price road use on uncrowded facilities, they provide a means to ration the limited highway capacity available during peak periods in highly congested areas. Further, because of the financial test imposed by the bond market, toll roads must pass a more stringent cost-effectiveness standard than do most roads built with federal funds.

Toll roads are usually built more rapidly than free roads, both because financing may be secured sooner than otherwise and because actual construction is completed faster. The more rapid construction may be the result of pressures to save on interest costs. Consequently, the economic benefits of a new road are available sooner. On average, toll roads are also in somewhat better physical condition. For example, in 1982 the typical nontoll Interstate route had a pavement condition rating of 3.5, classified as good on FHWA's five-point scale. In contrast, a sample of Interstate toll roads analyzed by the Congressional Budget Office had a median rating of 4.0, or very good (average ratings were 3.4 and 3.8, respectively). This difference translates into a 5 percent to 10 percent saving in costs for maintaining vehicles. It is not clear whether toll roads are in better condition because they have more resources available for maintenance, or because they are operated more efficiently than free roads. Certainly, travelers expect better service on toll roads.

One option for relaxing current federal restrictions on toll roads would be to permit the use of toll revenues to match federal funds in the construction of new roads. If this were done, the current federal matching ratio of 75 percent to 90 percent could be reduced for such projects. Toll roads already receive a federal subsidy of 15 percent to 25 percent as a result of the tax-exempt bonds used to finance their construction. Moreover, only relatively small additional subsidies appear to be needed to make more urban and suburban highways feasible as toll roads. For example, a subsidy equivalent to a 25 percent reduction in toll road costs would reduce the "break even" point for urban toll roads to a level reached by perhaps 15 percent of urban Interstate mileage. Thus, if federal funds were made available to cover 25 percent of the costs of building toll roads, this subsidy might be enough to encourage the construction of up to $1 billion a year in new toll roads. With new toll roads, current levels of highway construction could be maintained with about $500 million less in direct federal subsidies. The effect on the overall federal budget, however, would be partially offset by reduced federal tax receipts as from the new tax exempt bonds issued by the toll authorities.

Another option would be to permit the conversion of existing Interstate roads to toll facilities. This conversion would offer two potential benefits: first, it would provide an alternative to federal financing of major repairs; second, it might permit states that have experienced rapid

growth since construction of the original Interstate System to add road capacity sooner than would be possible otherwise. Because of the lower costs and the existing base of traffic, no additional federal financial help would be required. Indeed, it would appear logical to eliminate the eligibility of such roads for current federal repair funds (the so-called 4R program). A change in federal law, however, would certainly be required.

CONCLUSIONS

In conclusion, Mr. Chairman, the pending shortfall in the Highway Account is clearly the most important problem affecting the program. Although action could be deferred until the next major highway authorization, the shortfall will eventually require raising revenues, reducing the program, or both.