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Committee on Public Works and Transportation
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Mr. Chairman, I am pleased to appear before your Subcommittee to discuss the financial condition of the Highway Trust Fund. The Surface Transportation Assistance Act of 1982 raised highway and mass transit authorizations as well as increased user fees to finance this spending. In addition, this act subdivided the Highway Trust Fund into two accounts--the first to finance mass transit capital grants using receipts from one cent of the motor fuel tax, and the second to carry on the more traditional highway programs.

Our projections, however, show a need for further adjustments. In the Highway Account, outlays will exceed revenues, thus eliminating the cash balance by 1989. In the Mass Transit Account, revenues will exceed currently planned spending, leading to a substantial surplus.

My remarks this afternoon will address these adjustments in terms of: the basic principles that guide financially strong trust funds; the financial outlook for the Highway Account of the Highway Trust Fund; and the financial outlook for the Mass Transit Account, including its ability to support increased authorizations.

## GENERAL PRINCIPLES OF TRUST FUND FINANCING

Three general principles ensure the financial soundness of trust funds. First, there must be adequate cash on hand to cover expected outlays during the year. Second, the cash on hand in the trust fund plus the expected future receipts should be sufficient to pay off all the authorizations, or spending promises, that have been made; and third, and most important, outlays and receipts must balance in the long run.

In any given year, of course, outlays and receipts are likely to differ. Over time, however, if outlays exceed revenues the Congress must face the difficult choice between higher taxes or lower spending from the fund. This is the case with the Highway Account of the Highway Trust Fund. By contrast, if revenues exceed outlays, the basic choice is between reduced taxes or increased spending from the fund. This is the case with the Mass Transit Account.

## THE HIGHWAY ACCOUNT

The Highway Trust Fund provides a model for federal support of long-term construction projects. Highway users finance the federal highway program through a series of excise taxes paid into the Highway Trust Fund.

This approach is based on the well-accepted principle that those who use the nation's highway system, not the general taxpayer, should support its construction and repair.

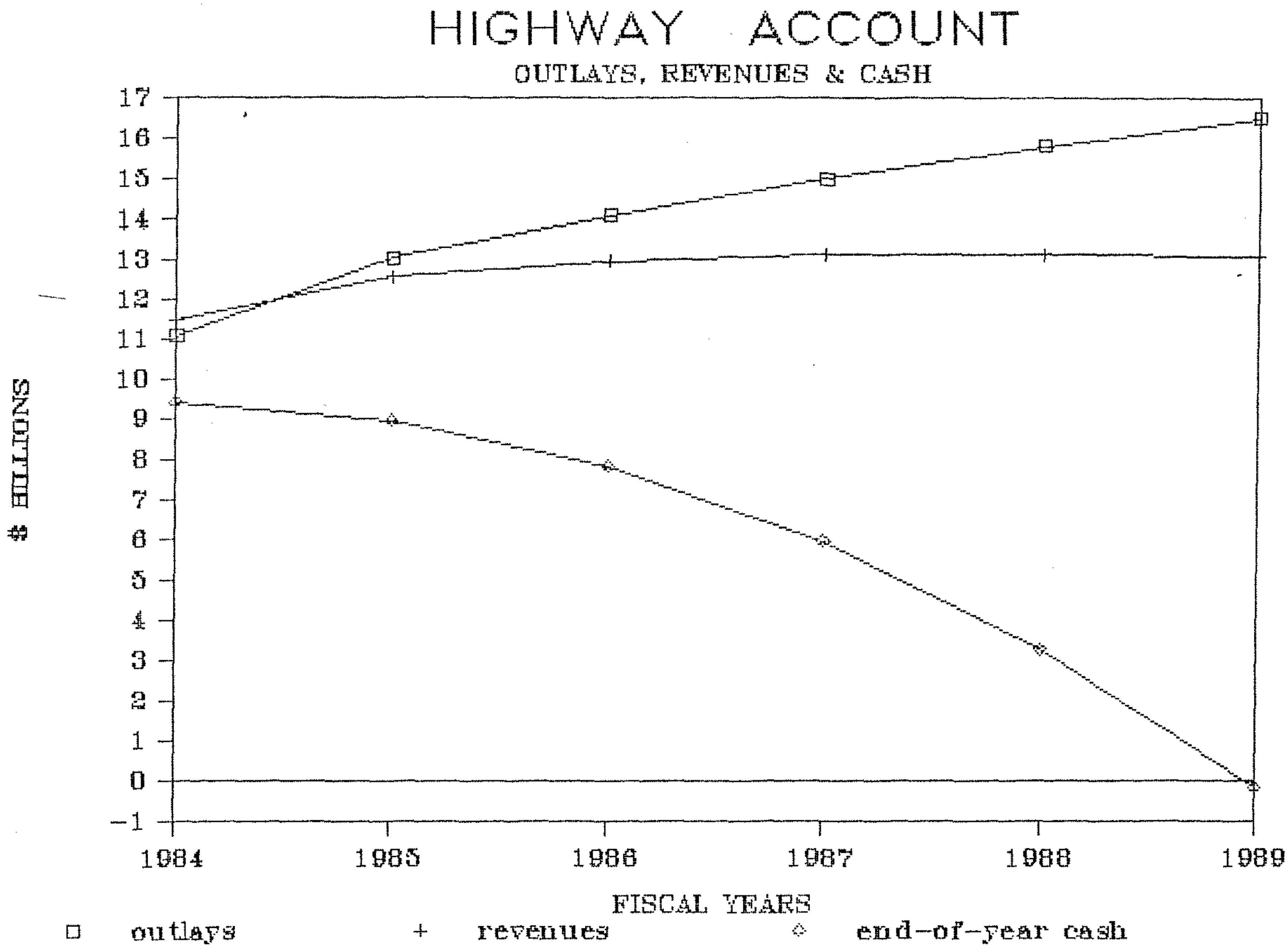
The most important financial control for the Highway Account is the Byrd Amendment, which has been in place since establishment of the Highway Trust Fund in 1956. The Byrd Amendment focuses on unfunded authorizations--that is, total unpaid authorizations less any cash on hand. This provision forces an automatic reduction in funds available to the states if the unfunded authorizations exceed expected revenues over the remaining life of the Highway Trust Fund. At present, the taxes that support the Highway Account continue through 1988, while 1986 is the last year of authorization. Thus unfunded authorizations cannot exceed two years' worth of revenues. The Byrd Amendment also prohibits a negative cash balance in any year.

In the Surface Transportation Act of 1982, the Congress made the first major change in highway taxes in over 20 years. Taxes were increased by $3.8 billion per year to an average of $10.5 billion over the four years ending in 1986. When interest on the cash balance is added, total receipts should average about $11.5 billion per year. At the same time, authorizations were increased to an average of $14.4 billion per year. Thus annual authorizations exceed annual receipts by about $2.9 billion. Clearly such a gap cannot be sustained for long. To be sure, the trust fund can finance its commitment over the next two or three years, but only 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.

Figure 1 summarizes the financial condition of the Highway Account through 1989. It shows a rapid decline in the cash balance starting in 1986. By 1989, the cash will be exhausted. (Table 1, attached to this statement, provides additional details).

While these projections are subject to reasonable uncertainties in predicting tax receipts, outlays, and interest rates, there is no doubt about the ultimate need for action to restore balance to the Highway Account. If tax changes were made in 1986 or 1987, an increase of about $2 billion per year would be needed, depending, of course, on the level of future authorizations. This sum could be generated by higher motor fuel taxes--an additional 2 cents per gallon being roughly adequate. Three other options might also contribute to highway revenues:

- Higher taxes on heavy trucks that, as shown by recent DOT studies, currently pay only about 70 percent of their share of federal highway costs;


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

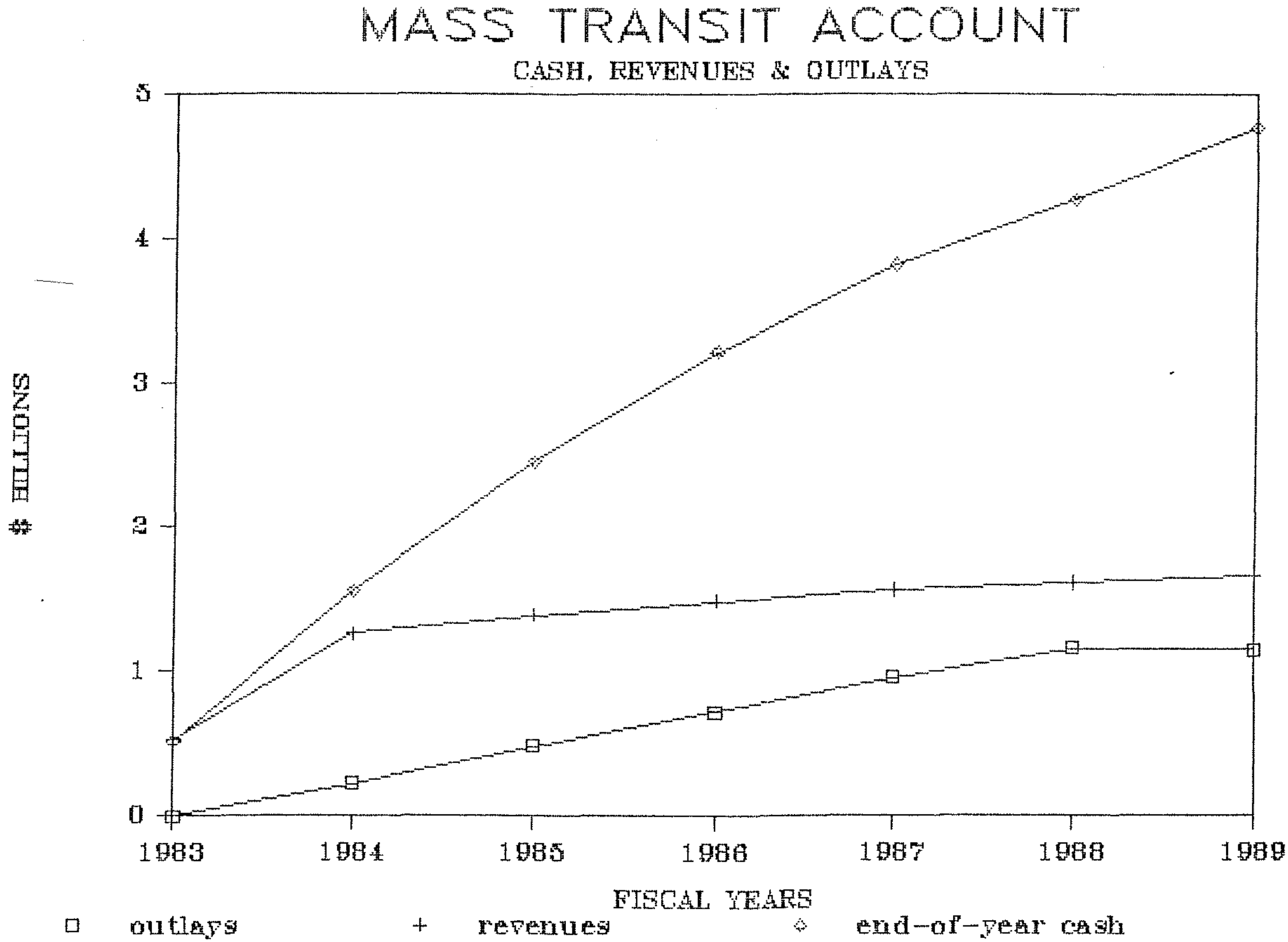
- o Reduced tax exemptions for gasohol, buses and taxis, and state and local governments, worth over $700 million per year at present; and
- o Use of surplus funds from the Mass Transit Account.

Of course, any increase in authorizations above current levels would imply an even larger tax or a more immediate one. Alternatively, spending could be decreased, perhaps by concentrating Interstate construction funds on gaps needed to complete an interconnected system, and delaying work on other routes until after 1990. This could cut approximately in half the current $4 billion per year of Interstate construction funding.

## THE MASS TRANSIT ACCOUNT

The financial condition of the mass transit portion of the Highway Trust Fund stands in sharp contrast to the Highway Account. As shown in Figure 2, revenues exceed outlays by a sizable margin and the cash balance shows rapid growth, exceeding $3 billion by the end of 1986 and approaching $5 billion in 1989. Revenues also show continuous growth as interest on the cash balance is added to the almost $1.2 billion a year generated by the motor fuel tax.

While the surplus generated by the Mass Transit Account is of some small help in offsetting the nation's $180 billion budget deficit, such use



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

diverts the trust fund from its intended purpose, that of financing new transit investments. There are two ways to move this account back toward a balance between outlays and revenues: decrease receipts or increase spending. In view of the financial problems facing the Highway Account, one option for decreasing receipts would be to transfer the interest earned on the cash balance to the Highway Account. Even without this interest--about $200 million in 1985 and $300 million in 1986--tax revenues alone appear adequate to support an increase in transit authorizations to $1.2 billion per year, up from the current $1.1 billion.

Of course, any increase in authorizations should be justified by the existence of cost-effective projects. With this in mind, the current level of receipts into the Mass Transit Account could support annual authorizations of up to $1.5 billon, a $400 million per year increase over the 1985 level. To sustain such a large increase, however, interest rates would have to remain near today's relatively high levels, as currently forecast by CBO. A significant drop in interest rates could place a $1.5 billion program in jeopardy, as would use of the mass transit cash balance to help meet a future shortfall in the Highway Account.

At present, most of the discretionary capital grants made from the trust fund are used for rail systems--divided between repairs to older systems and construction of new rail systems. Two issues arise when considering sizable increments to this program: first, how resources should be divided between cities with older rail networks and those building their first system; and second, how to select among cities with competing plans for new systems.

With regard to the first, objective criteria for deciding between modernization and new construction are difficult to find. Under current policy, the construction of new systems is encouraged by the 75 percent federal match provided by federal transit grants. Indeed, after including state funds, a locality may only have to pay for 10 percent of its construction costs. Because such projects require large amounts of capital they may dominate the financing of local transit for decades. Thus, there is cause for concern in the evidence that new rail systems have not always been able to achieve the benefits expected of them. With regard to demand, an earlier analysis by the Congressional Budget Office indicated that rail modernization accounted for between one-half and three-fourths of the demand for rail capital spending. 1/

The second issue, choosing among competing projects for new rail starts, could be more readily quantified. Decisions could be based on estimates of the relative cost per trip, comparisons of the expected costs

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1. Public Works Infrastructure: Policy Considerations for the 1980's (April 1983) p. 47.

and benefits over time, or calculations of the anticipated rate of return on capital. In many cases, the decision-making techniques used by private business can be adapted to mass transit investment decisions.

Finally, a higher local match for federal investment funds would be one way to encourage localities to focus on such basic objectives as cost-effectiveness in moving large numbers of people, rather than emphasizing capital-intensive projects simply because generous federal funding makes them financially attractive.

## CONCLUSION

The Highway and Mass Transit Accounts of the Highway Trust Fund present sharp contrasts. While the Highway Account faces a need for future tax increases or spending cuts, the Mass Transit Account has additional financial resources available, either to reduce taxes or to invest in cost-effective projects.

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 a/ | Cash Balance Start of Year | Change | Cash Balance End of Year | Unfunded Authorizations |
|---|---|---|---|---|---|---|---|
| 1984 | 14,120 | 11,100 b/ | 11,500 | 9,060 | 400 | 9,460 | 16,710 |
| 1985 | 14,860 | 13,180 b/ | 12,600 | 9,460 | (470) | 8,990 | 18,960 |
| 1986 | 15,660 | 14,100 b/ | 12,970 | 8,990 | (1,120) | 7,870 | 21,640 |
| 1987 | 16,320 c/ | 14,910 | 13,130 | 7,870 | (1,880) | 6,000 | 24,840 |
| 1988 | 16,980 c/ | 15,810 | 13,130 | 6,000 | (2,680) | 3,310 | 28,680 |
| 1989 | 17,630 c/ | 16,520 | 13,080 | 3,310 | (3,440) | (130) | 33,230 |

SOURCE: Congressional Budget Office.

NOTE: Totals may not add because of rounding.

a. Treasury forecast of tax receipts with Congressional Budget Office estimate of interest rates.

b. Level of outlays depends on when Interstate construction funds for 1984 are released.

c. Current policy projections by Congressional Budget Office..

TABLE 2. FINANCIAL PROJECTIONS FOR THE MASS TRANSIT ACCOUNT OF THE HIGHWAY TRUST FUND
(In millions of dollars)

| Fiscal Year | Mass Transit Authorizations | Outlays | Trust Fund Income a/ | Cash Balance Start of Year | Change | Cash Balance End of Year | Unfunded Authorizations |
|---|---|---|---|---|---|---|---|
| 1984 | 1,250 | 230 | 1,260 | 520 | 1,030 | 1,550 | 250 |
| 1985 | 1,100 | 490 | 1,390 | 1,550 | 900 | 2,450 | (40) |
| 1986 | 1,100 | 720 | 1,490 | 2,450 | 770 | 3,220 | (430) |
| 1987 | 1,160 b/ | 960 | 1,560 | 3,220 | 600 | 3,820 | (820) |
| 1988 | 1,230 b/ | 1,160 | 1,610 | 3,820 | 450 | 4,270 | (1,200) |
| 1989 | 1,290 b/ | 1,150 | 1,660 | 4,270 | 510 | 4,780 | (1,570) |

SOURCE: Congressional Budget Office.

NOTE: Totals may not add because of rounding.

a. Treasury forecast of tax receipts with Congressional Budget Office estimate of interest rates.

b. Current policy projections by Congressional Budget Office.