Improving the Performance of the Surface Transportation System: Revenue Options

Testimony of John Horsley, Executive Director
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for the

National Surface Transportation Policy and Revenue Study Commission

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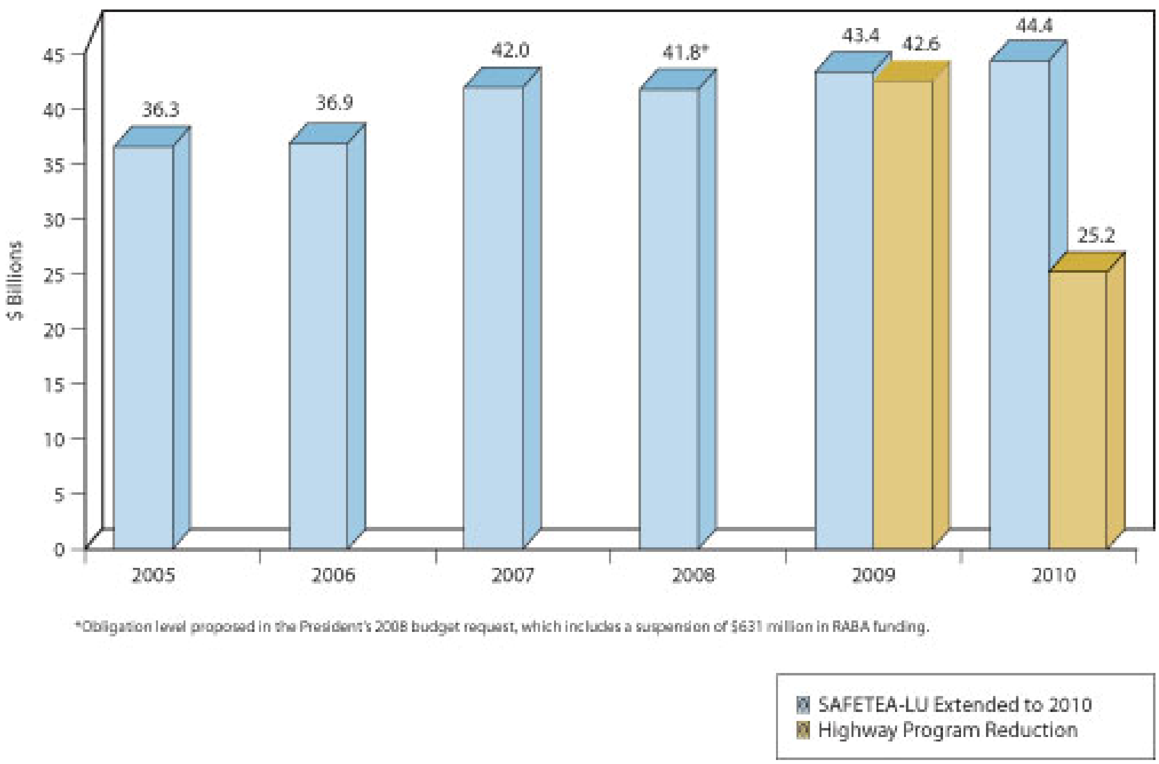
I appreciate the opportunity to testify on behalf of the Departments of Transportation from the 50 states, the District of Columbia and Puerto Rico, who are the Members of AASHTO. What I would like to address are Revenue Options we believe the Commission should consider.

1. The Highway Program's Immediate Crisis

When Congress authorized SAFETEA-LU at $286.5 billion in 2005, it was expected that revenues flowing into the Highway Trust Fund would be sufficient to support the program through the sixth and final year of the program. To meet the country's needs, Congress was urged to spend down the resources generated by the Highway Trust Fund to the absolute maximum extent possible. While it was expected that outlays would exceed revenues over the course of the bill by approximately $5 billion, it was estimated that the program would remain solvent long enough for other measures to generate the revenues necessary to sustain the program at the levels authorized in SAFETEA-LU.

The following chart illustrates the impending funding crisis facing the Highway Account expressed in highway program obligation levels.

Figure 1. **$18 Billion Cut in Federal Highway Program Obligations if Congress Takes No Corrective Action**

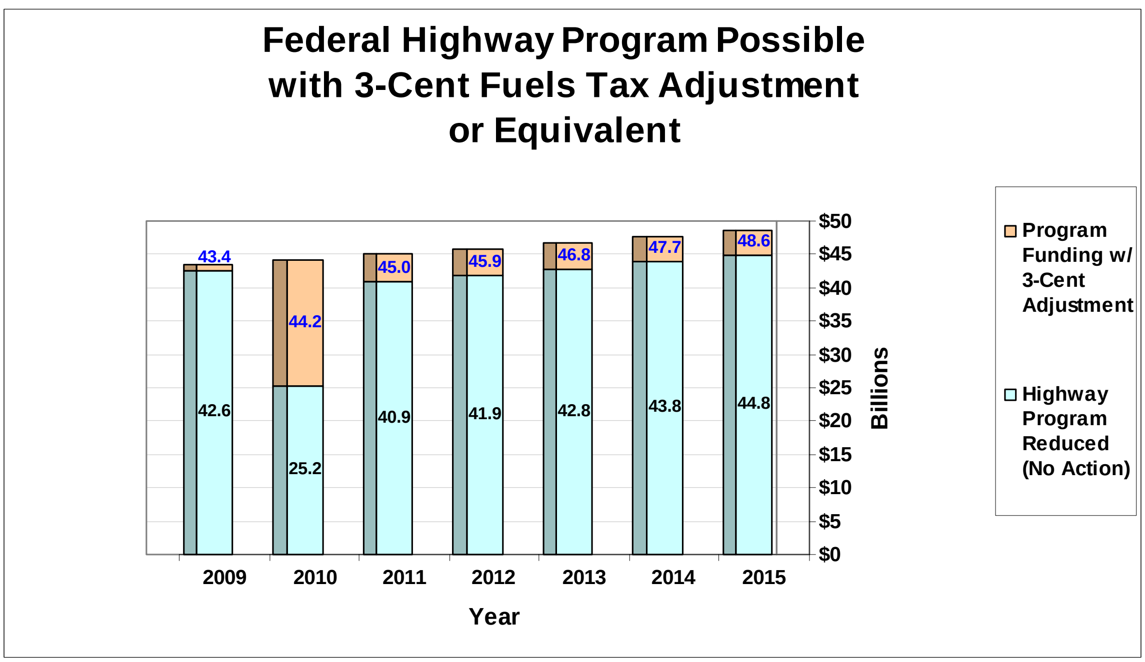


It now appears that the tipping point expected to hit in FY2010 may occur sooner. Based on the information provided in the President's budget for FY 2008, the highway program faces a funding crisis beginning in fiscal year 2009 and accelerating dramatically in fiscal year 2010. Current Highway Account revenue projections for 2009, show a shortfall of $200 million in revenue. That shortfall will require an obligation reduction in the highway program of just under $800 million, since it takes a reduction of just under $4 in obligations to save $1 in spending. In 2010 the deficit dramatically increases to $5.7 billion and would require an obligation limit reduction of $18.2 billion from the 2009 obligation level, a 42 percent reduction.

The federal transit program could suffer similar shortfalls and require massive program cuts beginning in 2012 as a result of current-law revenues that are inadequate to cover outlays. A cut of 32 percent from $10.3 billion in 2009 under SAFETEA-LU down to $7.0 billion in 2012 is currently estimated.

Figure 2 shows that with a three-cent fuels tax increase, or its equivalent in other revenue, the dramatic $18 billion highway program cut will be averted, and a modest growth in the highway program would be possible.

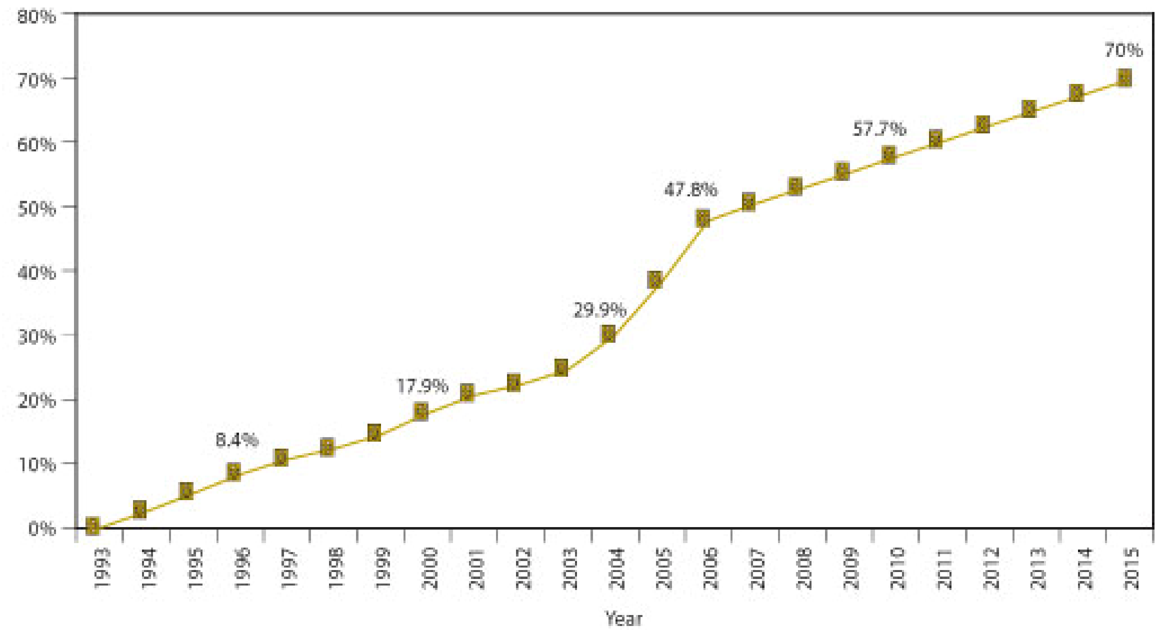
Figure 2



2. Restoring the Purchasing Power of Federal Assistance

Commodity prices for steel, concrete, petroleum, asphalt and construction machinery increased dramatically from 2004 to 2006. As a result, it is our estimate that between 1993, the year in which federal fuel taxes were last adjusted, and 2015, construction costs will have increased by at least 70 percent. To restore the purchasing power of the federal highway program, funding will have to be increased from $43 billion in 2009 to $73 billion by 2015.

Figure 3. **Percentage Increases in Construction Costs 1993-2015**



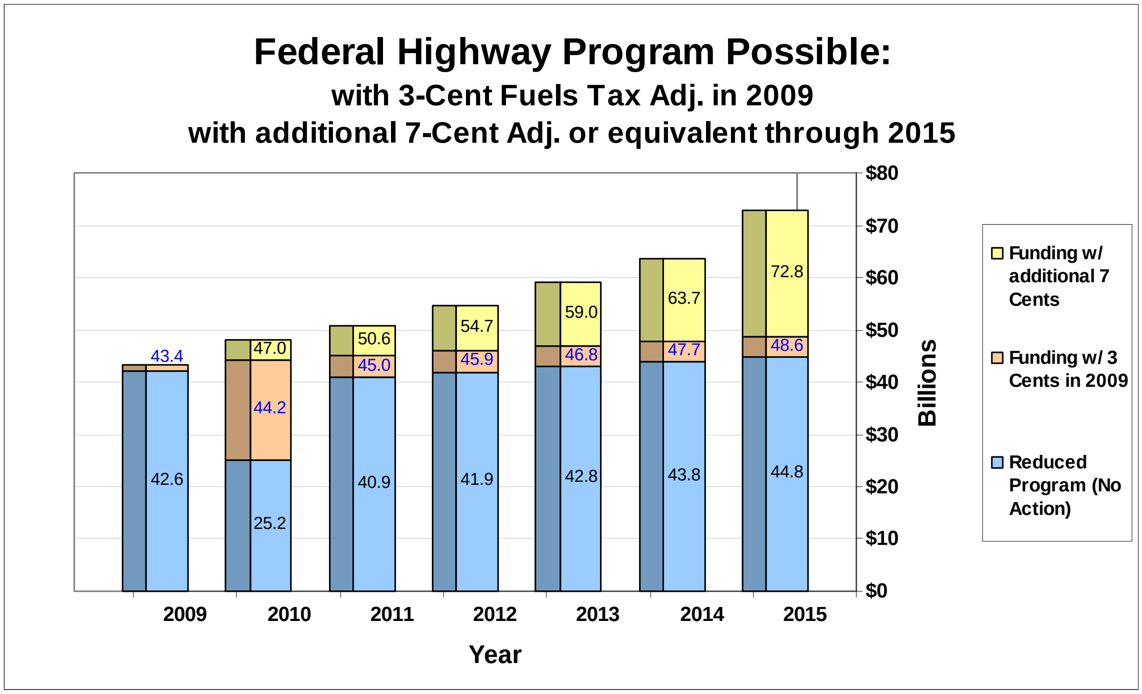
Note: Projected change from 2007 to 2015 based on the Consumer Price Index. Data for 2004 to 2006 based on the Producer Price Index for highway construction.

Adjusting Federal Fuel Tax Rates to Restore Program Purchasing Power

The Federal gas tax rates have remained static since 1993 when the rate was increased to 18.3 cents with 4.3 cents dedicated to the General Fund. The Highway Trust Fund did not receive any investment benefit until 1998. Our estimate of what it would take to restore the program's purchasing power is calculated to coincide with the recapture of the 4.3 cents revenue in 1998 under TEA-21. Inflation has and will continue to dramatically decrease the purchasing power of current revenues due to a lack of rate adjustments.

Because of the rising costs of construction, the value of the 18.3 cents Federal gas tax rate will decline 55 percent or to 8.3 cents between 1998 and the end of 2015, if corrective action is not taken to preserve Federal capital investment.

Figure 4



The Solution: Between 2010 and 2015, federal fuel taxes would have to be increased by 10 cents or its equivalent: The rate would need to be increased by 3 cents or its equivalent in 2009 to sustain the program at the level guaranteed in SAFETEA-LU. It would have to be increased by another 7 cents or its equivalent to restore the program's purchasing power. (Figure 4)

Transit. To restore the purchasing power of the transit program, federal funding will have to be increased from $10.3 billion in 2009 to $17.3 billion in 2015. To sustain their share at 55 percent of total spending in 2015, state and local governments would have to increase their investment to $21.1 billion.

3) All levels of government will have to continue to fund their shares of highway and transit investment if we are to increase funding to the levels needed.

To restore the highway program's purchasing power to the levels needed by 2015, spending nationally by all levels of government will have to increase to approximately $160 billion. Over the last 15 years, the federal share of highway capital spending has been 45 percent, and the state and local share 55 percent. That means that by 2015 federal highway assistance will have to increase by $30 billion and state and local investment by $35 billion. The only way such a massive increase will be possible is for all levels of government to continue to fund their historical shares.

All Levels of Government Must Continue To Fund Their Share

National Capital Investment in Highways

	2010	2015	Funding Increase Needed	New Toll Revenue	Net Required
Federal	**$43 billion**	**$73 billion**	**$30 billion**		**$30 billion**
State/Local	**$52 billion**	**$87 billion**	**$35 billion**	**$8 billion**	**$27 billion**
Total	**$95 billion**	**$160 billion**	**$65 billion**	**$8 billion**	**$57 billion**

Toll revenues, at $7.75 billion in 2005, represented 5 percent of national highway revenues for that year. AASHTO believes tolling and public private ventures supported through tolling will play an increasing role in meeting future needs, especially in adding needed new arterial capacity in rapidly growing urban areas. If toll revenues doubled by 2015, to $16 billion that would be enormously helpful. It would provide $8 billion of the $35 billion in additional annual spending required for states and local governments to fund their share of the increased highway investment needed. However, it in no way would reduce what would be required for the federal government to sustain its share of funding.

4) Short-term federal revenue options for the Highway Trust Fund (2010-2025)

There are several options to accomplish the dual objectives of sustaining the program at the levels authorized by SAFETEA-LU and then restoring the program's purchasing power.

Highway Trust Fund Options To Increase Revenues

	Highway Program Level Made Possible by 2021
10 Cent Rate Increase	**$75 billion**
10 Cent Rate Increase, Indexed to CPI	**$82 billion**
5 Percent Sales Tax on Gas (If fuel prices increase 4 percent annually)	**$85 billion**
14.2 percent Sales Tax on Gas in lieu of 28.4 Cent Gas Tax (if fuel prices increase 4 percent annually)	**$95 billion**

1. **A Ten Cent Rate Increase.** The first option is to increase federal fuel taxes by the equivalent of 10 cents. To avert a major cut in the highway program in 2009 would take the equivalent of a 3 cent fuel tax increase. To restore the purchasing power of the program would take the equivalent of an additional 7 cent fuel tax increase in 2010. If the gas tax were increased by 10 cents to a total of 28.4 cents, to maintain their historical shares, the diesel tax would have to be increased by 13 cents to a total of 37.4 cents. Our analysis shows that by 2021 the revenues made possible by this 10 cent increase could support a highway program of $75 billion.
2. **Index to the Consumer Price Index.** The second option is to index fuel tax rates to the consumer price index (CPI) from 2010 and beyond. According to our analysis, indexing rates to the CPI from 2010 forward could generate enough revenue to increase the highway program to $82 billion by 2021.
3. **Five Percent Federal Sales Tax on Motor Fuels.** A third option would substitute for the first. Instead of increasing fuel tax rates by 10 cents for gasoline and 13 cents for diesel, impose a federal sales tax on motor fuels at a rate that generates the equivalent amount of revenue. Assuming gas and diesel wholesale prices of $2.00 per gallon, an equivalent amount of revenue could be generated by a 5 percent sales tax on gasoline and a 6 percent sales tax on diesel fuel. This would result in a tax structure at the national level similar to that in California, which levies a motor fuel excise tax of 18 cents per gallon, and a state sales tax on motor fuels of 7.25 percent. If during the six years from 2015 to 2021, fuel prices increased by 4 percent annually, having a 5 percent sales tax in place could support an $85 billion highway program by 2021.
4. **Replace the 18.4 cent Federal fuel tax with a 14.2 percent Federal Sales Tax on Gasoline and replace the 24.4 cent Federal tax on diesel with an 18.7 percent Federal sales tax on diesel.** Assuming gas and diesel wholesale prices of $2.00 per gallon, a sales tax rate of 14.2 percent generates revenues equivalent to a fee per gallon of 28.4 cents. An 18.7 percent sales tax on diesel generates revenues equivalent to a fee per gallon of 37.4 cents. Converting the entire federal fuel tax to a percentage rather than just the ten cent portion, would make it even more responsive to fuel prices. A floor would have to be imposed so that revenue generation is not adversely affected if prices dropped below a given rate such as $2.00 per gallon. If during the six years from 2015 to 2021, fuel prices increased by 4 percent annually, revenues would enable the highway program to increase to $95 billion by 2021.
5. **Index the Heavy Vehicle Use Tax to 2010 or 1997.** The current Heavy Vehicle Use Tax, with the maximum rate set at $500, has remained constant for more than two decades. This option assumes that this fee would be adjusted for inflation starting in 2010. Cumulative revenues from 2010 to 2015 are estimated at approximately $1 billion. If this change were

made retroactive to 1997, to gain half the purchasing power lost since 1984, this would produce approximately $17 billion over six years.

5) Federal Funding Options Outside the Highway Trust Fund

The last several decades have witnessed dramatic growth in freight demand, driven by economic expansion, global trade, and revolutionary changes in business logistics. Today, the nation is entering the early stages of a freight transportation capacity crisis. There also remains great difficulty in finding sufficient revenue at the federal level to stabilize Amtrak funding and to assist many intercity passenger rail corridor projects.

There are several options for generating revenues outside the Highway Trust Fund which have potential.

- **Investment Tax Credits.** The Association of American Railroads is pushing for federal investment tax credits for rail improvements which improve capacity. AASHTO has indicated its support for this concept, providing that a satisfactory mechanism for determining public benefit can be mutually determined with the railroads. It is estimated that this measure could generate new private investment capital of $6 billion over a five-year period, or the equivalent of $1.2 billion per year.
- **Dedicating 5 percent of Customs Fees for Port Access and Intermodal Freight Projects.** Dedicating 5 percent of customs fees to port intermodal connections via rail and highways would bring in $1.8 billion per year. Customs revenues are derived from duties on imported goods passing through international gateways. The transportation of these goods imposes significant costs on ports, intermodal facilities, and the surrounding communities.
- **Container Fees.** Another idea is the imposition of a container fee of $30 on every 20-foot cargo container, which would be placed in a trust fund dedicated to freight-related improvements nationwide. If applied at all U.S. ports, it is estimated that this could generate in the range of $2 billion per year.
- **Tax Credit Bonds**. In 2005, Senators Talent, Wyden, Coleman and Corzine introduced a “Build America Bonds” program which would have made $50 billion in tax credit bonds available through a transportation finance corporation. AASHTO had developed a similar concept. The tax credit bonds would be long-term debt issued by a federally-chartered, non-profit Transportation Finance Corporation (TFC). Instead of interest payments, investors would receive an annual tax credit which they could use to offset their federal tax liabilities. The proceeds from the $50 billion in bonds the TFC could be authorized by Congress to issue would go to fund projects including freight rail and intercity passenger rail improvements, highway corridors of national significance, freight

bottleneck solutions, and transit new starts. $8 billion to $10 billion annually could be made available through this six-year program.

Federal Revenue Options Outside Highway Trust Fund

	6-year Revenue 2010-2015
Investment Tax Credits for Railroads	**$ 7 billion**
5 percent of Customs Fees or $30 Container Fee	**$12 billion**
Federal Tax Credit Bonds (50 percent for Freight Projects)	**$25 billion**
Subtotal for Freight Projects of National Significance	**$44 billion**
Federal Tax Credit Bonds (50 percent for Passenger Projects)	
Subtotal for Highway, Passenger Rail, and Transit Projects	**$25 billion**

6) Long-term Federal Revenues -- The Need to Supplement or Replace Fuel Taxes between 2025 and 2035.

Long-term – Alternatives to Supplement or Replace Fuel Taxes

Study Viability of Vehicle Miles Traveled Taxes	**2010 - 2015**
Field Test VMT Technologies	**2015 - 2021**
Develop Implementation Plans for VMT Taxes	**2021- 2027**
Transition to VMT Tax	**2027- 2033**

For the period between 2015 and 2025, increasing fleet fuel efficiency and the increasing use of alternative fuels may begin to slightly erode Highway Trust Fund revenues. However, as the 2006 TRB Study, *The Fuel Tax and Alternatives for Transportation* concluded, as long as the reduction is in the 20 percent range, an adjustment in fuel tax rates would be a viable remedy.

In the period from 2025 to 2035, there is the prospect that increasing fleet fuel efficiency, use of alternative fuels, and higher fuel prices may combine to reduce revenues by as much as 50 percent. By this time federal and state governments need to have developed viable alternative sources of revenues to support continued investment in highways and transit.

Oregon's Mileage-Based Fee Field Test

Over the last three years Oregon has been field testing a mileage-based user fee, which could be the alternative needed. Oregon DOT anticipates that adoption of a mileage-based fee system will require legislative support which will need the understanding and support of the public. Enforcement and privacy concerns will have to be addressed. Several additional steps may be required including: testing and evaluation in other regions; funding for installation of vehicle and service-station technology; development of new state and federal legislation governing administration; and coordination with vehicle manufacturers, the fuel distribution industry and organizations representing the general public and the trucking industry.

What Oregon's experiment has demonstrated is the complexity of implementing such a system. Congress should be urged to fund additional pilots and studies during the next two reauthorization periods. By 2021, enough research should have been conducted on a Vehicle Miles Traveled user fee to determine how it can best be configured to supplement or replace the cents per gallon fuels tax by the period just beyond 2025, so implementation can take place. It would be highly desirable if consensus can be reached between the states and the federal government about which system to adopt, so motorists will only have to adjust to one approach at the pump.

A Commission to Adjust Transportation User Fee Rates. While the need for adjusting federal fuel tax rates is technically quite clear, the political challenge remains. We should also bear in mind that the last two times federal fuel tax rates were adjusted, it was done for deficit reduction rather than explicitly to increase transportation funding or restore the program's purchasing power. There is a mechanism which seems to work well in the field of military base closing which might be a model for what is needed for the Highway Trust Fund. The Base Realignment and Closure Commission (BRAC) is convened periodically to review the needs of the Department of Defense and to recommend base closures where facilities are no longer needed. An appeal period is provided. However, once the final list is submitted to Congress it is considered on an up or down vote. No amendments are allowed.

If Congress chooses not to index rates or impose a sales tax, there is an alternative which might help. Congress could create an impartial board called the Transportation Revenue Advisory Commission (TRAC). Its mission would be to periodically review whether the rates of federal fuel taxes and other fees supporting the Highway Trust Fund were set at levels sufficient to sustain the program at the levels needed. Once the Commission's recommendation is made, after an established review period, the recommendation would take effect unless Congress voted during the review period to reject it.