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SURFACE TRANSPORTATION

Funding Limitations and Barriers To Cross-Modal Decision Making

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Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to testify on key issues affecting the implementation of the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA) and the results of some of our past and ongoing work in the area of surface transportation infrastructure. Making surface transportation investment decisions has become increasingly complex because decision makers need to address deterioration of the nation's roads, bridges, and transit systems; traffic congestion; air quality; energy efficiency; and mobility for the elderly and disabled.

ISTEA authorized an unprecedented level of funding to help meet transportation needs, and also gave state and local governments more flexibility to determine how funds should be distributed between highway and transit projects. My testimony today will address (1) the current fiscal realities that may threaten to limit investment opportunities, (2) the potential ramifications of authorizing new demonstration projects, (3) the use of funding flexibility, and (4) the need for improved analytic tools for making intermodal investment choices. In summary:

-- The financial outlook for the highway account of the Highway Trust Fund is worsening. Revenues to the account are expected to fall $12.5 billion short of ISTEA's funding commitment to the states, according to January 1993 projections developed by the Federal Highway Administration (FHWA). If the revenue outlook does not improve and no remedial action is taken, the consequence will be that FHWA will be required to cut state highway apportionments by approximately $4 billion in each of fiscal years 1995 through 1997, the end of the ISTEA authorization period.

-- ISTEA authorized 539 demonstration projects which accounted for over $6.2 billion of the total authorization. While some demonstration projects address critical transportation problems and can be considered nationally significant, authorizing a large number of new demonstration projects will both worsen the financial outlook for the highway account and reduce states' opportunities to maximize the payoff from their highway investments. The financial problems of the highway account would be exacerbated because demonstration projects often cost more than expected. Frequently, they are authorized at a level below their full cost, which may necessitate the authorization of additional federal funds. Moreover, demonstration projects can yield a low payoff for a variety of reasons, including the fact that they often languish in early project development stages and indeed may never be started at all. In addition, they are often not aligned with transportation priorities and thus fail to respond to states' and regions' critical transportation needs.

-- In the context of limited resources, identifying and selecting transportation investments that promise to provide the greatest return on investment is especially important. ISTEA includes provisions permitting states increased opportunities to use highway funds for mass transit and nontraditional projects such as high-occupancy vehicle (HOV) lanes and vice-versa. This funding flexibility in turn allows state and local decision makers to target funds to the areas of greatest need. However, in our ongoing work we have found that few funds have been used flexibly to date. In fiscal year 1992, less than 3 percent of flexible highway funds were used to finance mass transit and nontraditional projects and about 3 percent of flexible mass transit capital funds were used to finance nontraditional projects. A variety of barriers stand in the way of states and localities thinking and acting cross-modally. These include restrictions on the use of state fuel tax revenue and the fact that highway and mass transit infrastructure needs exceed available resources.

-- While ISTEA encouraged a total systems approach to select among transportation alternatives, state and local decision makers may need help in meeting this goal. For example, the state of the art in comparing transportation alternatives is not well advanced. Development of cross-modal criteria and improved analytic tools under the leadership of the Department of Transportation's (DOT) Office of Intermodalism and Bureau of Transportation Statistics could assist decision makers in making trade-offs between projects both within a mode and across modes. Such assistance will be critical as states and localities identify the right mix of projects, regardless of mode, that address the myriad objectives facing transportation decision makers.

I will now address these points in greater detail.

<u>FINANCING CONCERNS DOMINATE THE HIGHWAY SPENDING HORIZON</u>

Of ISTEA's total $155 billion authorization through fiscal year 1997, over $122 billion was targeted to federal-aid highway projects. It was initially expected that revenues derived from the federal fuel tax and other highway-related taxes would be adequateto support this level of funding.[1] However, subsequent revenue forecasts prepared by the Department of the Treasury and released in July 1992 projected that tax receipts would grow more modestly than previously expected. On the basis of the July 1992 revenue estimates and the assumption that ISTEA would be less than fully funded, we reported in September 1992 that the highway account faced a shortfall.[2] Total revenues to the account were expected to fall about $6 billion short of meeting outstanding authorized funding by the end of the ISTEA authorization period.

Highway Account's Financial Outlook Is Worsening

Since our report was issued, the outlook for the highway account has become worse for two reasons. First, as of January 1993 projected fuel and other highway-related tax receipts through fiscal year 1999 were expected to be a total of $3.2 billion lower than amounts projected in July 1992. The declining rate of revenue growth is largely due to revised national economic forecasts, as fuel tax receipts fluctuate with the number of miles driven each month, which in turn varies with the level of national economic activity and other key factors. Second, the balance of the highway account will be drawn down earlier than previously anticipated if the administration's economic stimulus package and long-term investment strategy, which support full funding of ISTEA from fiscal year 1993 through fiscal year 1997, are enacted. For the current year, for example, states may have the opportunity to obligate nearly $3 billion more than earlier expected. Under these revised assumptions, the shortfall will total $12.5 billion through the end of the authorization period, according to official administration projections developed by FHWA in January 1993.

The shortfall is calculated using a financial safeguard known as the Byrd Amendment, which serves as a safety mechanism to ensure that revenues to be credited to the highway account will be

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[1]The federal fuel tax is the primary component of all federal highway excise taxes. The federal gas and diesel taxes currently credited to the Highway Trust Fund are 11.5 cents and 17.5 cents per gallon, respectively. Note that these tax rates exclude an additional 2.5 cents per gallon for both fuels that is credited to the General Fund for deficit reduction, and an additional 0.1 cent per gallon that supports the Leaking Underground Storage Trust Fund.

[2]Highway Trust Fund: Strategies for Safeguarding Highway Financing (GAO/RCED-92-245, Sept. 15, 1992). The estimated shortfall was based on the assumption that obligation levels associated with Congressionally enacted obligation ceilings would on average be held to levels about $1.5 billion lower than the full authorization from the highway account each year.

sufficient to meet all outstanding authorizations. In brief, the Byrd Amendment requires that in any given fiscal year, the highway account's cash balance plus 2 additional years' revenues be sufficient to honor outstanding authorizations through that fiscal year.[3] Consideration of 2 future years' revenues is in keeping with the fact that existing highway law provides for the collection of fuel and other highway-related taxes for 2 years beyond authorizations.

The Byrd Amendment not only establishes a means of measuring the overall financial condition of the highway account, but also mandates FHWA to reduce states' apportioned funding if a shortfall is predicted. As shown on Attachment 1, under January 1993 projections, FHWA would be required to cut about $4 billion annually from states' apportionments in fiscal years 1995 through 1997.

Increased Revenue Stream Would Safeguard Highway Financing

Our September 1992 report presented a number of strategies that the Congress could employ to prevent the apportionment reductions. Since that time, however, the magnitude of the shortfall has approximately doubled. Furthermore, the President's long-range investment proposal advocates the extension of a 2.5-cent portion of the fuel tax currently scheduled to expire at the end of fiscal year 1995. In recognition of these significant changes, we would like to focus on two specific approaches for dealing with the shortfall.

First, the threatened shortfall could be eliminated if the Congress extended and credited to the highway account the 2.5-cent portion of the fuel tax currently targeted to deficit reduction and scheduled to expire at the end of fiscal year 1995. While the administration advocates the continued collection of the 2.5 cents beyond 1995, it remains an open question whether these funds will be applied to uses other than the Highway Trust Fund. If all the receipts from the 2.5 cent portion of the tax were credited to the highway account, FHWA's January 1993 estimates show that the account's uncommitted balance at the end of the ISTEA authorization period would total about $1.8 billion. This is $800 million more than the minimum $1 billion safety cushion FHWA officials have recommended to guard against unforeseen decreases in revenues.

[3]Although the calculation associated with the Byrd Amendment does not directly consider obligation levels, obligation levels can have an indirect effect on the outcome of the calculation. This is because obligations have a bearing on the highway account's cash balance, which is a direct input to the calculation.

A second approach would be to collect fuel and other highway-related taxes currently credited to the highway account for 3 years beyond the authorization period (through fiscal year 2000), instead of the current 2 years. Similarly, the Byrd Amendment would be changed to consider 3 instead of 2 future years' revenues. These actions would increase the amount of revenue available to offset outstanding authorizations. While this approach has the apparent advantage of satisfying the Byrd Amendment, it has some serious disadvantages as well. First, while extending the revenue stream would satisfy the Byrd Amendment, this action would have no effect on the sufficiency of current revenues to sustain a positive cash balance in the highway account. This would mean that the highway account would be unable to support reimbursing states for their expenditures. A second concern with extending the revenue stream is that by relying even more heavily on future revenues, uncertainty about anticipated revenue levels would be increased. This is because the further revenue projections stretch into the future, the greater the potential margin for error in the estimate.

SELECTION AND FUNDING OF DEMONSTRATION PROJECTS COULD BE IMPROVED

Recent surface transportation legislative actions have generated a proliferation in funds authorized for highway demonstration projects and the number of these projects. Highway demonstration, or special, projects fall into several distinct categories, but are generally specific construction projects identified by name in legislation. They can range in scope from paving a gravel road to building a multilane highway. ISTEA included 539 demonstration projects with an accompanying authorization of $6.2 billion. This amount represents almost a five-fold funding increase compared to the 1987 reauthorization, which included $1.3 billion for 152 highway demonstration projects.

Some demonstration projects address critical transportation needs, but their high costs can preclude a state's capacity to fund them in the near term. Thus, the authorization of federal demonstration funds for such projects can prove essential to spurring their development. However, authorizing a large number of new demonstration projects could be problematic for a variety of reasons. First, authorized federal funds combined with the required state match are often not sufficient to complete the projects. Second, demonstration projects are often not aligned with state and regional transportation priorities. Third, the purchasing power of demonstration project funds is often limited by a slow rate of obligation.

Demonstration Projects Exacerbate Financial Outlook

The financial problems of the highway account will be exacerbated if more demonstration projects are authorized through supplemental appropriations, or if additional funds are authorized for already approved demonstration projects that are underfunded. This is because new demonstration projects increase total authorized funding, and thus increase total potential liabilities to be met from the highway account.

Demonstration projects will compound the financial difficulties facing the highway account because these projects frequently cost more than initially expected. In our 1991 review of 66 highway demonstration projects in 8 states, we found that the cost to complete these projects frequently exceeds authorized funding levels.[4] We reported, for example, that across all the projects reviewed, the federal funding and state match together comprised only 37 percent of total anticipated project costs. States therefore planned to use other federal, state, and local funds to cover about half of the additional $1.2 billion needed to complete the projects. State officials, however, were uncertain how they could cover the remaining needs. The tendency of the projects to cost more than originally expected will present an additional drain on the highway account if extra funds must be authorized and appropriated in future years to cover the cost of project completion.

Projects Typically Do Not Meet Top Priorities and Have Limited Payoff

In addition to worsening the financial status of the highway account, demonstration projects often provide limited benefits. One reason is that these projects frequently are not aligned with key transportation priorities. For example, in 1991 we found that a majority of the demonstration projects we reviewed did not appear on state or regional transportation plans before they were authorized. Thus, these projects did not receive the same degree of scrutiny as do projects undertaken through established federal-aid highway plans and programs.

A second reason why the payoff from demonstration projects is limited is that they often have problems causing them to languish in an early project development stage long after authorization. In our review, we found that these problems ranged from threatened intrusion on wetlands to citizen opposition. For example, one proposed highway construction project we reviewed would have cut through a low-income housing project undergoing renovation with federal funds. We also found that demonstration projects tend to have a slow rate of obligation; in 1991, only 36 percent of funding authorized for demonstration projects 4 years earlier had been obligated. Indeed, funds for demonstration projects may never get obligated; for 22 of the 66 projects we reviewed, none of the

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[4] Highway Demonstration Projects: Improved Selection and Funding Controls Are Needed (GAO/RCED-91-146, May 28, 1991).

authorized funds ($92 million) had yet been obligated, even though the projects had been authorized 4 years earlier. There is no provision for recapturing or redistributing the demonstration projects' budget authority to other programs, and thus there is no guarantee that the authority will ever be used for either demonstration projects or other transportation needs.

A final concern with demonstration projects is that in addition to being costly and offering little return on investment, the projects tend to draw funds away from major federal-aid highway programs such as Interstate Maintenance, the National Highway System, and the Surface Transportation Program. Because demonstration projects are exempt from obligation limitations, the annual obligation limitation must be lower than it would be otherwise. Moreover, when the obligation limitation is applied to states' apportionments, demonstration projects emerge unscathed. If demonstration projects were similarly subject to the obligation limitation, states would have more flexibility to target obligational authority to their core federal-aid programs.

In our 1991 report, we raised a series of possibilities for improving the current approach to selecting and funding demonstration projects. As you will see on Attachment 2, we would like to outline a few of them today. One possibility for improving project selection would be to authorize only those projects that are already incorporated in existing transportation plans. Turning to funding policy, we noted that one possibility would be to finance demonstration projects through existing federal-aid highway program categories. In addition, we recommended that the Congress consider instituting a "use-it-or-lose-it" demonstration project provision requiring the cancellation or redistribution of federal funds for any demonstration projects that remain inactive 4 years after their authorization.

LITTLE INITIAL USE OF ISTEA FUNDING FLEXIBILITY

ISTEA provided unprecedented opportunities for states and local governments to use federal funds flexibly for highway, mass transit, or nontraditional projects, such as HOV lanes and ridesharing programs. An estimated $80 billion of ISTEA's total $155 billion authorization may be used flexibly. To date, however, our ongoing work has found that states and local governments have made limited use of ISTEA's funding flexibility provisions. In fiscal year 1992, less than 3 percent of flexible federal-aid highway funds ($319 million) were used to finance mass transit and nontraditional projects and about 3 percent of flexible mass transit capital funds ($31 million) were used to finance nontraditional projects.

Use of Funding Flexibility Spurred By Air Quality Concerns

Where funding flexibility has been exercised, it has largely been concentrated in the Congestion Mitigation and Air Quality Improvement (CMAQ) program--an FHWA program designed to address air quality problems. Approximately 50 percent of CMAQ's $340 million in total obligations has financed mass transit and nontraditional projects. Even within the CMAQ program, the greatest use of funding flexibility was concentrated in five states that accounted for about 75 percent of the CMAQ cross-modal investments.[5]

Traffic congestion and air quality seem to be playing an important role in funding flexibility decisions. For example, CMAQ funds have financed mass transit and nontraditional projects in areas experiencing severe congestion and air quality problems, such as the Northeast. The funds are being used to finance such projects as HOV lanes, bus purchases, and transit passenger facilities such as bus shelters, each of which qualifies as a transportation control measure under the Clean Air Act Amendments of 1990. There are a number of reasons why congestion and air quality will likely continue to exert a major influence over decision makers' choices to use funds flexibly. First, 70 percent of peak hour urban Interstate travel in 1991 was under congested conditions. Second, 38 states have nonattainment areas--that is, areas that do not meet national air quality standards for at least one pollutant. Finally, in 1991, 6 out of 10 people in the U.S. lived in nonattainment areas.

Hindrances to Funding Flexibility

Although congestion and air quality are key considerations in the decision-making process, a variety of other factors may hinder states and localities from thinking and acting cross-modally. For example, some state departments of transportation have not historically had a large involvement with mass transit programs and therefore may be reluctant to transfer funds for nonhighway uses. Local as well as state officials we talked to agreed that adapting to ISTEA's changes would not occur over night. In addition, not all state and local funds can be used flexibly for matching fund purposes. In 1991, 35 states restricted the use of their motor fuel tax revenues to highway or bridge use only; therefore, about $13.5 billion out of total state motor fuel tax collections of $19.3 billion could not be considered for mass transit projects. Finally, highway and mass transit infrastructure needs continue to exceed available resources. Officials from all five states we visited expressed concern about their ability to meet infrastructure needs. As an official from one state we visited

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[5]New York, New Jersey, Massachusetts, Illinois, and Virginia.

noted, any new money received from ISTEA was not enough to cover the tremendous backlog of projects in the pipeline. As a result, this state official believed use of funding flexibility would be discouraged.

IMPROVED TOOLS NEEDED TO SUPPORT CROSS-MODAL INVESTMENT DECISIONS

Rather than focusing on only one form of transportation at a time, ISTEA encourages an intermodal approach to dealing with transportation issues. States and localities are expected to consider all modes of transportation in developing transportation plans. However, they may need help in accomplishing these goals. We reported in April 1992 that DOT could better assist state and local governments by developing a common basis for comparing and evaluating projects in various transportation modes--highway, mass transit, or some combination.[6] Such criteria would provide a common basis for quantifying a project's ability to meet mobility, environmental quality, cost-effectiveness, safety, and social and economic objectives. Current highway and mass transit selection criteria do not facilitate such comparisons and choices. We recommended that DOT develop cross-modal comparison criteria to better assist state and local decision makers in identifying those projects, regardless of mode, that most effectively deal with congestion and air quality problems. Such criteria have not yet been developed even though state and local officials we talked to continue to believe that such criteria are necessary for making investment decisions.

As we reported in December 1992, DOT could also better assist state and local decision makers by supporting the development of methodologies for data collection and analysis to compare projects.[7] Our ongoing work focuses on that need in one area--the capacity of existing analytic tools to determine the air quality impacts of transportation projects. Although methods and models exist for forecasting travel demand in urban areas and for identifying emissions rates of various vehicle types, the state of the art in evaluating air quality impacts of transportation projects is not well advanced. In general, travel demand models were originally developed some 20 to 30 years ago to analyze the need for new or modified highway facilities. Because these models often do not incorporate or fully recognize such factors as vehicle speed or type, they are now ill-suited to be used to analyze the air quality impacts of transportation projects. Officials from all 10 states and 9 metropolitan planning organizations (MPO) we

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[6]Transportation Infrastructure: Urban Transportation Planning Can Better Address Modal Trade-offs (GAO/RCED-92-112, Apr. 2, 1992).

[7]Transportation Issues (GAO/OCG-93-14TR, Dec. 1992).

contacted cited problems in evaluating the air quality impacts of transportation projects with existing information and models. In fact, one MPO we visited expressed such concerns over existing techniques and tools that it had deferred use of CMAQ funds until it had more confidence in determining the emission reduction benefits of CMAQ proposals.

A mechanism to collect data and develop methodologies to help states and localities address the above problems exists through DOT's Office of Intermodalism and Bureau of Transportation Statistics. These offices were created to develop and disseminate transportation data and provide technical assistance to states and localities. The development and dissemination of criteria, methods, and models under the leadership of these offices could assist state and local decision makers not only in comparing projects in different transportation modes but also in evaluating the projects' impact on such objectives as air quality. As we reported in December 1992, depending on the success these new offices have in fostering an intermodal approach, DOT may also need to consider other organizational changes such as creation of a Surface Transportation Administration to encompass the missions currently performed by separate rail, highway, and transit agencies. Assistance to states and localities will be critical as they identify the mix of projects, regardless of mode, that address problems such as congestion and poor air quality, while developing an intermodal transportation system.

CONCLUSIONS

Cuts of the magnitude needed to eliminate the shortfall in the Highway Trust Fund will work counter to efforts to stimulate the economy and spur long-term infrastructure investment. A number of strategies could be employed to deal with the shortfall, but many of these approaches would do nothing more than mask the imminent problem. On the basis of January 1993 assumptions and expectations, the solvency of the highway account could be ensured and apportionment cuts prevented by extending the 2.5-cent fuel tax currently supporting deficit reduction and applying a substantial portion of it to the highway account starting in fiscal year 1996 and continuing through fiscal year 1999.

Since transportation needs far outstrip available resources, federal funds should be targeted to the most significant transportation problems facing the nation. While some existing demonstration projects could be classified as nationally significant, others do not even appear on a state transportation plan. Therefore, improvements in processes for selecting and funding such projects could better target limited resources. For example, selection criteria might require that the projects' significance be demonstrated through their inclusion in existing transportation plans. In the area of funding, if a demonstration project remains inactive 4 years after its authorization, cancelling it or redirecting its authorized funds will help to ensure that the funds are effectively spent.

ISTEA changed the environment in which surface transportation choices are made by providing states and local governments with an unprecedented opportunity to use federal funds flexibly for highway, mass transit, and nontraditional projects. To date, however, the use of highway and mass transit funding flexibility has been limited. At the federal level, DOT can help to address some of the barriers to the use of flexible funding. For example, it can assist states and local governments both by developing cross-modal comparison criteria and by fostering development of improved analytic tools for assessing the impacts of transportation investment choices.

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Mr. Chairman, that concludes my testimony. I would be happy to respond to any questions that you or other members of the Subcommittee might have.

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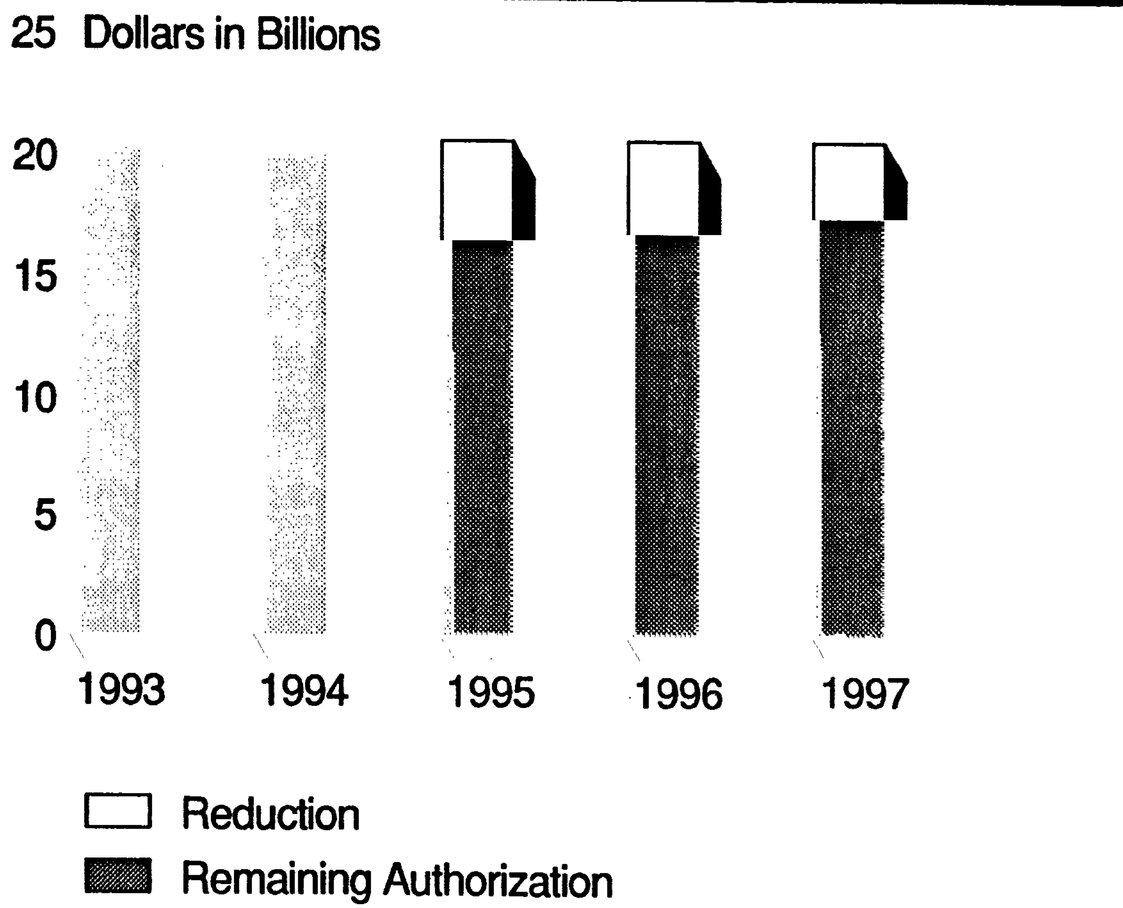
Projected Required Reductions in Apportionments, FY 1993-1997



Source: GAO analysis of FHWA data. Projections are based on January 1993 revenue estimates.

Attachment 1

GAO

Actions to Improve Demo Project Selection and Funding

- Restrict Selection to Projects Appearing on State Plans

- Change Project Funding Policy By:

    - Eliminating Project-Specific Authorizations

    - Instituting "Use It or Lose It" Provision

Attachment 2

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