

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

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NOTICE

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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 the resulting implications for the current federal highway program. Considerable change has occurred over the last year. As a result of Congressional concern with controlling the federal deficit, this year's estimated highway fund obligations have been reduced to \$13.4 billion, some \$2.2 billion below the level originally planned for 1986. This spending restraint makes the Highway Trust Fund appear financially stronger than it has for several years. My testimony today discusses options for refocusing the federal highway program, both to ensure the most cost-effective use of the limited funds that are available and to emphasize those areas of greatest federal interest.

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. The most recent major highway legislation was the Surface Transportation Act of 1982, which, among other changes, increased the federal tax on motor fuel by five cents to nine cents per gallon, with receipts from one cent of the tax dedicated to mass transit. This act extended the taxes through fiscal year 1988, with 1986 the last year of program authorization.

Altogether, the 1982 legislation raised the gross annual receipts for the highway program by almost \$5 billion. With interest on the cash balance added, receipts should total about \$12.9 billion in 1987. At the same time, however, annual authorizations were increased to \$15.6 billion in 1986--about \$2.7 billion more than expected receipts.

The main financial control mechanism for the Highway Account of the trust fund is imposed by the Byrd Amendment, which has been in effect since the Highway Trust Fund began in 1956. The Byrd Amendment focuses on unfunded authorizations--that is, total unpaid authorizations less any cash on hand. In an attempt to restrict spending before the cash balance becomes depleted, this provision forces an automatic reduction in funds available to the states if unfunded authorizations exceed revenues expected over the next two years.

In recent years, to limit spending, the Congress has imposed a ceiling on annual highway obligations. Thus, federal grants to states have been restricted to sums less than those originally authorized by the Congress (see Table 1). But since authorizations have not been limited concurrently, the Byrd Amendment may now have the unintended effect of imposing additional restrictions on spending well before an unsound cash position is reached.

TABLE 1. COMPARISON OF FEDERAL HIGHWAY AUTHORIZATIONS AND OBLIGATION LIMITS IN RECENT YEARS (In billions of dollars)

Fiscal Year	Total Authorizations	Obligation Ceiling for Federal-Aid Highways	Total Highway Obligations <u>a/</u>	Authorization Minus Obligations
1983	12.9	12.4	13.0	(0.1)
1984	14.0	12.520	13.2	0.8
1985	15.2	13.250	14.3	0.9
1986	14.9	12.2	13.4	1.5
1987	15.5 <u>b/ c/</u>	12.7 <u>b/ c/</u>	13.75 <u>b/ c/</u>	1.75
1988	16.0 <u>b/</u>	13.2 <u>b/</u>	14.25 <u>b/</u>	1.75

SOURCE: Congressional Budget Office.

- a. Includes a small amount of obligations not under the ceiling.
- b. CBO baseline estimates.
- c. The deficit targets in the Balanced Budget Act of 1985 imply an 8.4 percent cut in obligations and authorizations below the level for 1986. If the act is implemented, it could reduce total highway obligations to \$12.3 billion, the ceiling on obligations for Federal-Aid highways to \$11.2 billion, and total authorizations to \$13.6 billion in 1987.

Last year the Congress made two significant cuts in the ceiling on highway obligations. First, as part of the continuing resolution (P.L. 99-190), obligations for the Federal-Aid Highway System were set at \$12.75 billion for 1986, some \$1.7 billion below the amount set in the 1982 Surface Transportation Act. This change was motivated both by concern that the Highway Trust Fund had become overextended financially as well as by an interest in controlling the overall federal deficit. Second, the Balanced Budget and Emergency Deficit Control Act of 1985 called for a 4.3 percent cut in many domestic spending programs for 1986. This cut reduced obligations from the Highway Trust Fund by another \$600 million for 1986. If the automatic reductions called for by the Balanced Budget Act take effect again in 1987, obligations could be cut by an additional 8.4 percent, or some \$1.1 billion.

As a result of these changes, the projected financial strength of the fund has improved greatly. For example, under CBO's baseline assumptions--which do not include a spending cut in 1987--the cash balance in the Highway Trust Fund is projected to be \$5.1 billion in 1990. Although the cash on hand is substantial, the Byrd Amendment would be triggered in 1988. Even if authorizations were reduced to equal total obligations, the Byrd Amendment would still be triggered in 1990 (see Table 2).

Figure 1 compares the trust fund balance under this baseline spending path with those under two other paths--one implied by the level originally

TABLE 2. FINANCIAL PROJECTIONS FOR THE HIGHWAY ACCOUNT OF THE HIGHWAY TRUST FUND UNDER CBO BASELINE
(In millions of dollars)

Fiscal Year	Authorizations	Total Obligations	Outlays	Income ^{a/}	Start of Year Cash Balance	Change	End of Year Cash Balance	Unfunded Authorizations
1986	14,900	13,400	13,900	12,900	10,380	(1,000)	9,380	20,850
1987	13,750	13,750	13,550	12,850	9,350	(700)	8,650	21,750
1988	14,150	14,150	13,600	12,850	8,650	(750)	7,900	23,050
1989	14,750	14,750	14,150	12,900	7,900	(1,250)	6,650	24,900
1990	15,350	15,350	14,600	13,000	6,650	(1,550)	5,100	27,200 ^{b/}
1991	15,900	15,900	15,150	13,250	5,100	(1,900)	3,200	29,850

SOURCE: Congressional Budget Office. Obligations, outlays, and income are from CBO's baseline forecast which adjusts 1986 levels for inflation. Authorizations have been set equal to obligations.

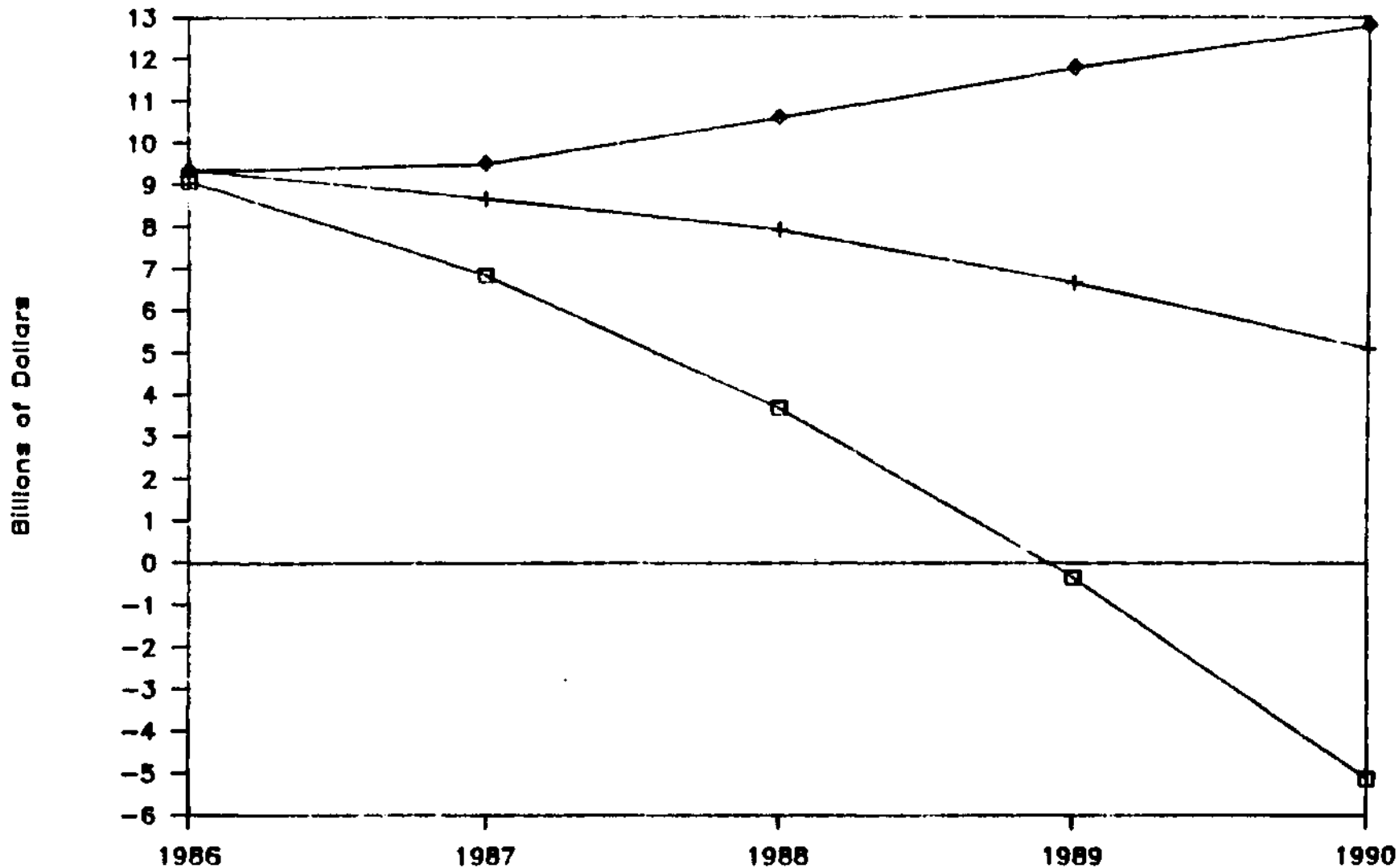
NOTE: Totals may not add due to rounding. Parentheses denote negative numbers.

a. Includes tax revenues plus interest earned on the cash balance. Assumes that current highway excise taxes are extended beyond 1988.

b. Byrd Amendment criterion would be triggered. If authorizations were not set at obligations, but adjusted for inflation, the Byrd criterion would be hit two years earlier, in 1988.

FIGURE 1: HIGHWAY TRUST FUND OPTIONS

End-of-Year Cash Balance



□ 1986 Baseline

+ 1987 Baseline

◇ Administration

SOURCE: Congressional Budget Office.

NOTE: Administration proposal assumes elimination of exemptions for gasoline and private buses.

authorized in 1986, and the other implied by the Administration's highway proposal. The latter would set authorizations and obligations equal to estimated tax receipts, excluding any interest earnings.

ALTERNATIVE WAYS TO CONTROL SPENDING

While obligation ceilings do effectively control outlays and improve the status of the trust fund, they suffer from the same drawbacks as the across-the-board cuts called for under the Balanced Budget Act of 1985. High priority programs are cut as much as less important ones. No attempt can be made to match budget cuts with federal highway priorities. Moreover, ceilings on obligations effectively transfer control over highway priorities from the federal government to state highway departments. The states, rather than the federal government, now choose how to allocate \$2.2 billion in program cuts among various highway programs: completion of the Interstate, bridges, road repair, and so forth. Two other control mechanisms could achieve similar spending reductions with a more sensible allocation of funds. These mechanisms concern highways with a clear national interest and programs with more local interest.

Interstate System

The first mechanism involves the Interstate system. Many of the roads in this system connect cities in different states and thus are of clear national interest. About 1,100 miles of Interstate highways remain to be built, at an estimated cost of \$23 billion.

Current budgetary pressures suggest the need for financial mechanisms that select the most beneficial projects. CBO has developed a very crude measure of the net benefits of completing the remaining gaps in the Interstate highway system. High priority roads are those where first year benefits exceed 10 percent of total construction costs; lower priority roads have first year benefits of less than 10 percent.

Table 3 divides these "High" and "Lower" priority roads into those with primarily national significance (that is, connecting cities in different states) and those others with primarily local significance. The key number in the table is in the upper left-hand corner: about one-fifth of the remaining Interstate costs are for high priority routes of primarily national importance.

Mechanical ceilings on obligations, such as the one now imposed, will encourage state highway departments to focus on roads with primarily

local significance--the second row of Table 3. An alternative approach that makes more sense from a national standpoint is to develop a control mechanism that encourages highway departments to focus on the roughly one-half of the Interstate gaps with primarily national significance--the first row of Table 3. This mechanism could be developed most easily by retaining present generous federal matching rates for just the gaps with national significance and not for those with primarily local importance. If the present matching rates were made less generous for all highway programs, attention would be further focused on high priority roads with national significance. Either mechanism would cut down on trust fund outlays, but provide for a better allocation of those outlays that remained.

TABLE 3. REMAINING INTERSTATE GAPS GROUPED BY NATIONAL SIGNIFICANCE AND BY ESTIMATED RATE OF RETURN (In percent of cost to complete)

Category	High Priority	Lower Priority	Total
Primarily National Significance <u>a/</u>	20.6	28.9	49.5
Primarily Local Significance <u>a/</u>	<u>26.0</u>	<u>24.5</u>	<u>50.5</u>
Total	46.6	53.4	100.0

SOURCE: Congressional Budget Office.

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

Urban and Secondary Roads

A second control mechanism involves roads of mainly local interest--namely, the urban and secondary roads, and roads not part of the federal system. The federal government spends nearly \$2 billion a year on the repair and construction of these roads. The most direct way to limit outlays in this area would be to turn complete responsibility 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, states would now be free to set their own engineering and labor regulations.

The Administration's proposal for a transportation block grant is a step in this direction. By combining highway and transit funds, it would give localities the ability to trade off the strengths of each in solving local transport problems. The Administration plan calls for \$2.2 billion in highway funds to be combined with \$1.1 billion now supported by the one cent of the motor fuel tax dedicated to mass transit.

Toll roads represent a related problem. Since 1916 federal aid has been prohibited on these roads. The Administration has proposed relaxing this restriction but would continue the current 75 percent federal matching rate. But if its block grant approach were followed, it is not clear why toll

roads--most of which are of local importance--could not simply be lumped into roads eligible for funding under the block grant.

REVENUE OUTLOOK

An alternative way to prevent slippage in the highway fund's cash balance is, of course, on the revenue side. A straightforward penny rise in the motor fuel tax would raise income to the trust fund by about \$1.2 billion.

There is another factor. Over the past few months, the price of oil has dropped considerably, from about \$30 a barrel last November to less than \$15 a barrel in the futures markets today. CBO's baseline estimate of trust fund revenues assumes oil prices of about \$23 per barrel in 1987. If the average cost to refiners stays below this level, however, revenues from the tax on motor fuels--and other highway excise taxes--will be higher than those projected in the baseline. Motor fuel use, and thus trust fund revenues, could be affected in four different ways.

First, in the short term, people will drive their existing vehicles somewhat more: planning more vacation trips by automobile, and so forth. Motor fuel use is not particularly sensitive to small shifts in price: a 10 percent change in the pump price of fuel is likely to result in only a 1 percent to 1.5 percent increase in driving. Nevertheless, if oil prices were to remain at \$15 per barrel for just a year, federal highway excise tax revenues would increase by about \$400 million annually. 1/

Second, the longer the drop in oil prices persists, the greater the impact on fuel use is likely to be as consumers and businesses become less concerned with fuel economy in their purchases of new vehicles. Thus, the average fuel economy of new cars would be less than with higher prices, although still well above that of most older vehicles. For example, if oil prices were to remain at \$15 a barrel through 1991, the expected trust fund revenues could increase by as much as \$1 billion a year by that time.

Third, lower oil prices might also make gasohol production uneconomical. Because they are exempt from six cents of the nine cent per gallon federal tax on gasoline, gasohol producers receive a federal subsidy of 60

1. This amount represents the expected change in revenues to the Highway Trust Fund. The effect on total federal revenues would be about 25 percent less.

cents per gallon of ethanol (gasohol contains 10 percent ethanol and 90 percent gasoline). Even with this support, and similar exemptions from many state gas taxes, gasohol may not be a competitive substitute for gasoline if the gas price drops sufficiently. The eventual effect on the trust fund could also be significant, since the gasohol subsidy now reduces trust fund receipts by about \$500 million a year.

Finally, lower oil prices would have an effect on the level of real GNP, and thus highway use by autos and trucks. As a rule of thumb, each percent increase in GNP (Gross National Product) results in one percent more highway use. The magnitude of any economic shifts is quite speculative since other economic forces, most importantly monetary policy, may offset this impact. In any case, the possibility of higher GNP levels means that our estimate of the effect of lower oil prices on fuel use could be conservative.

That concludes my prepared remarks, Mr. Chairman. I would be pleased to answer any questions you might have.