Statement of

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Funding and Financing Surface Transportation Investment: Findings and Recommendations of the National Surface Transportation Infrastructure Financing Commission

Before the

Committee on the Budget

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Chairman Spratt, Mr. Ryan, and members of the Committee, I appreciate the opportunity to address the issue of budgeting for transportation before this committee and to share with you the relevant findings and recommendations of the National Surface Transportation Infrastructure Financing Commission, of which I serve as the commission chair. I am also President of the Information Technology and Innovation Foundation.

Congress established the National Surface Transportation Infrastructure Financing Commission in the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users and charged it with analyzing future highway and transit needs and the financings of the Highway Trust Fund and making recommendations on alternative approaches to funding and financing surface transportation infrastructure. The Commission has recently completed and released our final report entitled "Paying Our Way: A New Framework for Transportation Finance." The recommendations offered in this report focus on transforming the way we, as a nation, pay for critically needed surface transportation investments. The report is signed on behalf of all fifteen Commissioners and represents a carefully deliberated consensus of opinion about the various strategies that we believe, together, can help solve our surface transportation investment crisis and provide a useful road map for transitioning to a new financial policy framework.

Today, I will share with you those findings and recommendations that I believe would be of most interest to the Committee on the Budget and relevant to this hearing. I will highlight the Commission's findings and recommendations as they relate to surface transportation investment and, in particular, near and longer-term budget implications as well as describe the full menu of options that the Commission considered.

Background: A System in Crisis

Our surface transportation system has deteriorated to such a degree that our safety, economic competitiveness, and quality of life are at risk. As a nation, we have reaped the benefits of previous generations' foresight and investment, generations that developed and built a transportation system that became the envy of the world. Over the last few decades we have grown complacent, expecting to be served by high-quality infrastructure, even as we devoted less and less money in real terms to the maintenance and expansion of that infrastructure. Real highway spending per mile traveled has fallen by nearly 50 percent since the federal Highway Trust Fund was established in the late 1950s. Total combined highway and transit spending as a share of gross domestic product (GDP) has fallen by about 25 percent in the same period to 1.5 percent of GDP today. By not adjusting the tax rate for inflation, federal gas tax receipts have experienced a cumulative loss in purchasing power of 33 percent since 1993—the last time the federal gas tax was increased. And, not only have we failed to make the needed and substantial investment; we have failed to pursue the kind of innovation necessary to ensure that our infrastructure meets the demands of future generations.

An ever-expanding backlog of investment needs is the price of our failure to maintain funding levels—and the cost of these needed investments grows yearly. Without changes to current policy, the Commission has estimated that revenues raised by all levels of government for capital investment will total only about one-third of the roughly $200 billion necessary each year to maintain and improve the nation's highways and transit systems. At the federal level, the investment gap is of a similar magnitude, with long-term annual average Highway Trust Fund (HTF) revenues estimated to be only $32 billion compared with required investments of nearly $100 billion per year. The Commission relied heavily on previous efforts by the U.S. Department of Transportation, the National Surface Transportation Policy and Revenue Commission, and others to define the extent of the needs and forecast revenues for the future. The Commission did, however, develop its own refinements to account for currently available information as well as our own hypotheses for the future (see Chart 1 and 2).

Chart 1. Average Annual Capital Needs and Gap Estimates, **All Levels of Government, 2008 – 2035 (in 2008 dollars):**

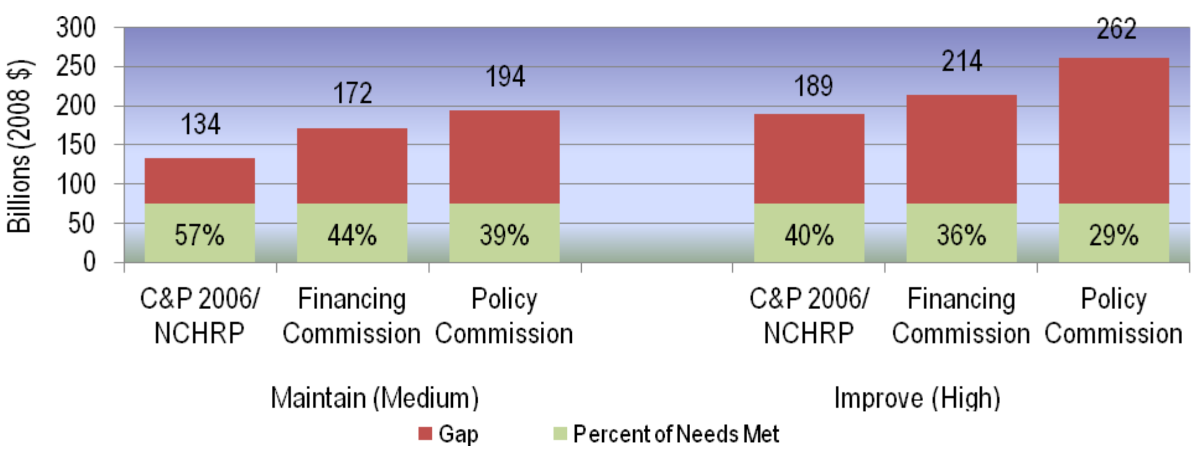
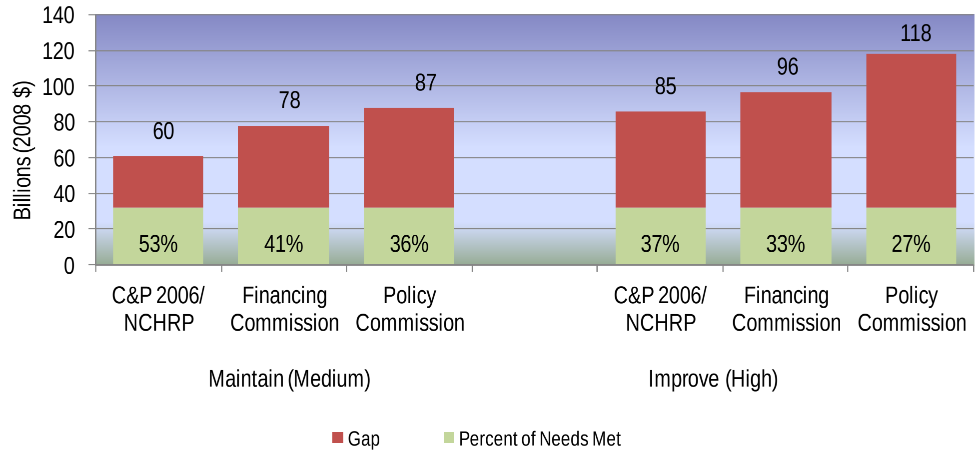
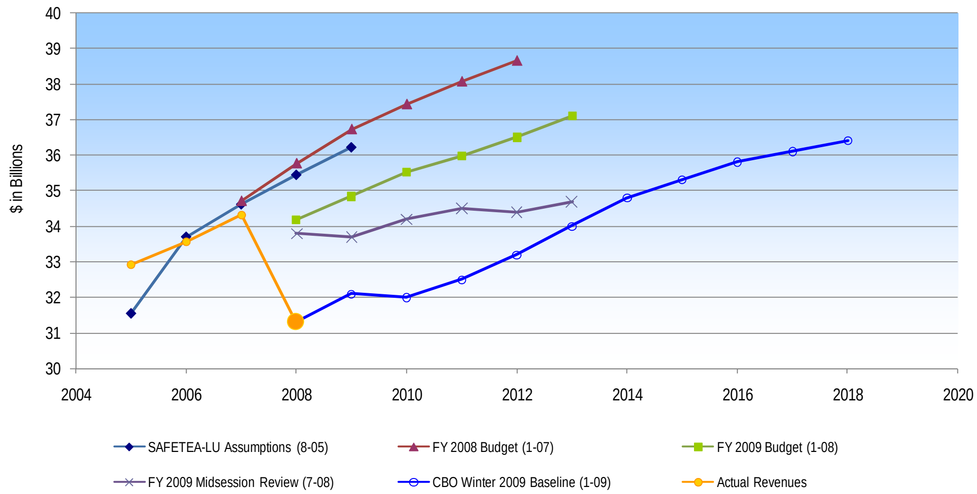


Chart 2. Average Annual Capital Needs and Gap Estimates, Federal Government, 2008 – 2035 (in 2008 dollars)



Meanwhile, the federal Highway Trust Fund faces a near-term insolvency crisis, exacerbated by recent reductions in federal motor fuel tax revenues and truck–related user fee receipts (see Chart 3). This problem will only worsen until Congress addresses the fundamental fact that current HTF revenues are inadequate to support current federal program spending levels. Comparing estimates of surface transportation investment needs with baseline revenue projections developed by the Commission shows a federal highway and transit funding gap that totals nearly $400 billion from 2010–15 and that grows dramatically to about $2.3 trillion through 2035.

Chart 3. Recent HTF / Highway Account Revenue Projections Since SAFETEA-LU



The Commission's Deliberative Process

To guide our work, the Commission developed a set of overarching principles to guide consideration of funding and finance approaches: The funding framework should:

- support enhancing mobility of all system users.
- generate sufficient funding to meet investment needs on a sustainable basis.
- cause users to bear the full cost of using the system to the greatest extent possible.
- encourage efficient investment.
- incorporate equity considerations.
- support energy and environment goals.

The Commission recognizes that there are inherent tradeoffs among these principles, which require some balancing among them. Working from the principles, the Commission developed systematic evaluation criteria to apply to a wide range of funding approaches. In recognition of the supporting role that financing mechanisms can play in leveraging resources—as distinct from the underlying revenue-raising mechanisms that generate net new resources—the Commission considered alternative financing approaches. The Commission developed specific policy recommendations to help narrow the federal funding gap and transform the funding and finance framework for the nation's investment in surface transportation infrastructure.

The Commission's Key Findings

The Commission arrived at the following findings of relevance to this Committee and this hearing:

- There is no easy "silver bullet" solution to the problem of insufficient funding. As an important corollary, not all approaches work equally well throughout a geographically and economically diverse country. The Commission therefore assembled a broad menu of options for Congress to consider, with an assessment of the pros and cons of each approach.
- The current federal surface transportation funding structure that relies primarily on taxes imposed on petroleum-derived vehicle fuels is not sustainable in the long term and is likely to erode more quickly than previously thought—due in large measure to heightened concerns regarding global climate change and dependence on foreign energy sources, which are creating a drive for greater fuel efficiency and new vehicle technology.
- The current indirect user fee system based on taxes paid for fuel consumed provides users with only weak price signals to use the transportation system in the most efficient ways. This results from three primary factors: system users are typically unaware of how much they pay in fuel taxes; fuel taxes and other user fees account for less than 60 percent of total system revenue (with other revenues unrelated to use, such as general fund transfers, dedicated sales taxes and others making up the remainder), so that users do not bear the full costs of their travel; and fuel taxes have no direct link to specific parts of the system being used or to times of the day and thus cannot be used to affect these kinds of traveler choices.
- A federal funding system based on more direct forms of "user pay" charges, in the form of a

charge for each mile driven (commonly referred to as a vehicle miles traveled or VMT fee system), is the right foundation for the future. The Commission cast a wide net, reviewed many funding alternatives, and concluded that the most viable approach to efficiently fund federal investment in surface transportation in the long run will be a user charge system based more directly on miles driven (and potentially on factors such as time of day, type of road, and vehicle weight and fuel economy) rather than indirectly on fuel consumed. At the same time, this choice for the federal system provides a foundation for state and local governments that choose to use it to implement their own mileage-based systems that piggyback on the federal system in order to raise their share of needed revenues in ways that spur more efficient use of the system. The Commission believes that such a system can and should be designed in ways that protect users' privacy and civil liberties, that does not interfere with interstate commerce, and that support goals for carbon reduction. Moreover, greater use of pricing mechanisms, including both targeted tolling and broad-based VMT pricing systems, can spur more efficient use of our highway network and, by shifting demand to less congested periods of the day or to other modes, may in some areas of the country, reduce the need for additional capacity investments.

- We cannot afford to wait for a new revenue system to be put in place to start addressing the fundamental investment challenge. And, in the short term, effective and feasible options are limited. Given the significant current funding shortfall, the Commission concluded that the best near-term options for federal investment are increases to current federal fuel taxes and other existing HTF revenue sources. While the Commission believes these are the best near-term approaches, we acknowledge that other options are possible should Congress choose to pursue different revenue measures.

- Federal actions can and should help expand the options available to states and localities to fund their shares of investment. While many state and local funding options are not reliant on the federal government for implementation, several key federal actions could help facilitate and encourage the greater application of some—specifically, user-backed funding approaches such as tolling and pricing—to help meet a portion of state and local government investment needs.
- Funding and financing are not the same. Financing approaches are not a substitute for solving the underlying problem of insufficient funding. Properly structured financing techniques and governmental financial programs, including those focused on facilitating partnerships with the private sector, can play an important role in meeting our investment needs. Their success, however, will depend on their ability to leverage new revenue streams to repay upfront capital investments. Even with this, financing approaches will have limited positive impact if not coupled with substantial net new resources.

Policy Recommendations

The Commission realizes that the transition from the current funding and finance model to a new model cannot be made overnight and that the immediate needs are simply too critical to wait until such a system is put in place. The Commission therefore makes the following recommendations for a multi-pronged approach to meet both short-term and longer-term challenges.

Ensuring the Security and Sustainability of the Highway Trust Fund

The Commission recognizes the fundamental value of the Highway Trust Fund—not only today but also as the appropriate foundation for any new user-based revenue system for surface transportation investment in the future. The Commission therefore offers an overarching recommendation to preserve the Highway Trust Fund mechanism and take any necessary actions to help ensure its security and sustainability in the near and longer term. This should include ensuring the integrity of the HTF structure premised on the link between user fees and transportation spending upon which the Trust Fund is based. It also should include continued efforts to reduce and minimize tax evasion and methods to align spending and receipts, with interest earned on any balances accruing to the Trust Fund.

As an important side note, I and other commissioners view the proposed budget scoring change included in the Administration's FY 2010 Budget that would eliminate contract authority for the transportation program as quite troubling. The Commission's emphasis on the link between system use and funding would be severely undermined by such a change. Further, contract authority provides critical predictability for state and local governments to enter into multi-year commitments for major transportation projects. This predictability has proven invaluable not only to supporting states' ability to enter into multi-year contracts but also to facilitating financing arrangements that span multiple years and even authorization periods. The Commission views protection of the Highway Trust Fund mechanism and the link to system use as critically important to preserving and improving the nation's ability to meet surface transportation investment needs and to do so in an efficient manner. Moreover, in an era of growing concern over global climate change, ensuring that more, not less, of overall funding for surface transportation comes from user fees, as opposed to general fund subsidies, is critical to help send the right price signals for efficient system use and minimizing carbon emissions.

Addressing Immediate Federal Funding Crisis

The Commission reviewed a wide range of options and concluded that the most viable option to meet near-term needs is to rely on existing HTF sources. The Commission, therefore, recommends that Congress enact a modest 10¢ increase in the federal gasoline tax, a 15¢ increase in the federal diesel tax – with 2¢ of the diesel tax proposal recommended to be dedicated for freight-related investments - and commensurate increases in all special fuels taxes. In addition, the Commission recommends that these taxes be indexed to inflation going forward. These adjustments should be enacted in conjunction with the upcoming reauthorization of the federal surface transportation programs. The Commission recognizes that the increases recommended here are not easy to achieve, especially in the context of the current economic recession, and that even larger increases would be even more difficult to enact. The Commission, however, views the need for this increase as critical to begin to stem the degradation of the Highway Trust Fund investments. It is also important to note that increases in fuel taxes, even in an economic slowdown would not have a contractionary effect on the economy as long as they are accompanied by increases in surface transportation investment – such investments therefore creating jobs across the country.

The Commission also recommends doubling the Heavy Vehicle Use Tax (HVUT) to account for the fact that it has not been increased since 1983, and indexing the HVUT and the excise tax on truck tires to inflation going forward. Meanwhile, the Commission recommends maintaining the current sales tax on tractors and trailers, which as a sales price-based tax is inherently adjusted (at least relative to the price of these items). The Commission considered a number of alternative freight-related revenue sources but determined that, while several of them may be viable options in targeted circumstances, most did not fairly account for the wear and tear on our transportation system by the freight community. The Commission therefore concluded that the best way to increase broad-based funds from freight sources in the short run is by adjusting the fees that the entire trucking industry currently pays into the Highway Trust Fund.

Together, these adjustments to current HTF funding mechanisms approximate the amounts required to recapture the purchasing power of the motor fuel taxes lost to inflation since 1993 - the last time the federal HTF taxes were raised – and the purchasing power of the Heavy Vehicle Use Tax since 1983, the last time it was raised. These adjustments translate into approximately $20 billion per year in additional revenue for the Highway Trust Fund. While this is necessary to fund the current level of federal commitments and helps alleviate a portion of the funding gap, it does not eliminate it—closing approximately 43 percent of the "cost to maintain" federal funding gap and 31 percent of the "cost to improve" gap based on the Commission's estimates. Addressing the remaining annual funding gap will require either more substantial increases in current taxes or additional revenue from other sources, or both.

Positioning Federal Funding for the Longer Term

Beyond the Commission's near-term recommendations and in order to transition to the longer-term solution of funding based on mileage charges, the Commission recommends that the transition to a new funding framework based on more direct user charges be commenced as soon as possible and that a goal of deployment by 2020 be established Because of the complexity inherent in transitioning to a new revenue system and the urgency of the need, the

Commission recommends that Congress embark immediately on an aggressive research, development, and demonstration (RD&D) program. This would identify and address critical policy questions such as privacy, administrative methods and costs, impacts to rural users, point of collection issues, the difference between passenger and freight vehicle deployment, and the interplay with climate change and other national policy goals. Comprehensive study of these issues will better inform Congress as it debates whether or not to move forward with a VMT system. The Commission recommends that Congress use the reauthorization of the federal surface transportation programs to make significant investments in VMT research and technology programs, including a variety of demonstration programs of mileage-based user fee systems.

The Commission notes that simply shifting from one revenue system to another will help but not solve the under-investment problem if rates are not set at sufficient levels and maintained over time to meet the needs. While a mileage-based direct user fee system is sustainable in the long term, it will suffer at least some of the same consequences as the motor fuel tax system if rates are not set and maintained at adequate levels. For illustrative purposes, the Commission estimates that to meet the base case "Need to Maintain and Improve" annual investment level, the federal VMT fee assessed on all miles driven, regardless of the system where they occur, would be roughly 2.3¢ per mile for cars (equivalent to a 48.4¢ gas tax). For a VMT system to raise the same amount of revenue as the Commission's recommendations to increase current motor fuel and truck-related taxes, the fee level for cars would be about 1.4¢ per mile. The fee level that equals current motor fuel and truck-related tax revenue would be about 0.9¢ per mile. These rates would be somewhat higher if assessed only on miles traveled on the federal-aid highway system as opposed to all highway miles. However much revenue Congress decides to raise at the federal level, the Commission believes it is critical to move forward with a VMT fee system.

Once a national VMT fee system is in place, and assuming that rates are set at a sufficient level, the need for the motor fuel–based revenue sources for the federal HTF will be eliminated. To the extent, however, that surface transportation fuels are subject to a charge in the future to account for their carbon emissions (e.g., a carbon tax or priced through carbon trading), an appropriate portion of those proceeds should be credited to the HTF and dedicated to funding carbon-reducing transportation strategies.

Facilitating Non-federal Investment in the Short and Medium Term

Beyond the immediate steps necessary to address the federal funding crisis and position the nation for a new direct user charge system, the Commission believes steps are imperative to expand the ability of states and localities to use other options to fund non-federal surface transportation infrastructure investment. Historically, states and localities have contributed over 55 percent of transit and highway capital investment, and they have shouldered primary responsibility for the extensive costs of operating and maintaining the system. The Commission believes that carefully targeted federal incentives can help spur new approaches at the state and local level, including tolling and pricing, thereby fostering greater overall investment that will in turn allow federal HTF dollars to go farther. The Commission offers the following recommendations for federal policy and programs to help facilitate state and local investment:

- Expand the ability of states and localities to impose tolls on the Interstate System by allowing tolling of net new capacity; allow tolling of existing Interstate capacity in large metropolitan areas (of 1 million or more in population) for congestion relief; expand the

Interstate Highway Reconstruction and Rehabilitation Pilot Program from three slots to five; and support standardization of tolling and information systems by completing necessary rulemaking regarding electronic tolling and interoperability.

- Reauthorize the federal credit program for surface transportation (originally authorized by the Transportation Infrastructure Financing and Innovation Act of 1998 and now commonly referred to as TIFIA) with a larger volume of credit capacity, broadened scope, and greater flexibility to make credit commitments. In conjunction with core credit assistance, authorize incentive grants to support and encourage the development and financing of user-backed projects. Such funding from the HTF could leverage considerably more funding at the state and local level than it would cost the federal government. The Commission recommends a total of $1 billion per year in budget authority for the TIFIA program for the following purposes:

  Credit Assistance ($300 million in annual budget authority)—to fund core credit assistance. The Commission also recommends several programmatic refinements.

  Pre-construction Feasibility Assessment Grants ($100 million in annual budget authority)--designed to address a key obstacle that states and localities face in advancing user fee-backed projects.

  Capital Cost Gap Funding Grants ($600 million in annual budget authority)—to provide incentive grants to states to complement TIFIA credit assistance. Recognizing that there are many projects for which partial (but not 100 percent) funding through user-backed revenue streams is possible, this program would provide grant funding to help close a portion of the estimated gap between the amount of capital for construction that can be derived from future user fees and the amount necessary to complete and maintain the facility for its useful life. Such a program could help spur states and localities to seek to build more new projects that rely at least in part on user-backed revenues, allowing federal funds to go farther since they would be supplemented by additional user-based revenues.

- Invest $500 million per year ($3 billion over a six-year authorization period) to re-capitalize State Infrastructure Banks (SIBs) and continue to allow states to use their federal program funds for this purpose. Providing this level of capitalization could help support a wide range of smaller projects that have the potential to leverage user-backed payments and other new revenue streams but that lack access to capital markets on a cost-effective basis.

- Take actions to facilitate and encourage private-sector financial participation where this can play a valuable role in providing cost-effective and accelerated project delivery, and support user fee–based funding approaches to meet capacity needs and, in particular, urban congestion. At the same time, ensure that appropriate governmental controls are in place to protect the public interest. Federal policy should also recognize the respective purviews of federal and state governments and should preserve and support the ability of state and local officials to impose appropriate restrictions on these arrangements.
- Expand the highway/intermodal Private Activity Bond (PAB) program from its current $15 billion national volume cap to $30 billion and limit the use of the program to projects that create net new capacity. Once the current turmoil in the financial markets subsides, it is anticipated that the existing capacity of the PAB program will be consumed quickly and more states and local sponsors will be looking to take advantage of this mechanism to lower financing costs for projects with private-sector financial participation.

The Path Forward—Conclusions and Next Steps

Mr. Chairman and members of the Committee, thank you for the opportunity to share the findings and recommendations of the National Surface Transportation Infrastructure Financing Commission with you today and for your interest in considering the Commission's findings in the context of setting the budget blueprint for the next ten years and beyond. On behalf of the Commission, I can state that the Commission members have appreciated the opportunity to serve on the Commission and to help Congress embark on this new era of surface transportation funding and to achieve a new and sustainable funding framework for the future. In offering Congress the results of our analytical and deliberative process, we recognize that there are no easy solutions. Looking to the future, however, we believe that transitioning to a system based more directly on use of the system, especially a mileage-based user fee system, is the right foundation.

I would be happy to answer any questions you may have.