

**Statement of
Tyler D. Duvall
Committee on the Budget
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Chairman Spratt, Ranking Member Ryan, I greatly appreciate the opportunity appear before the Committee today. Highway and transit system finance, once considered a relatively uninteresting topic, has now become an important national policy debate. This is due to the confluence of a variety of factors, including: anxiety related to projections of federal highway trust fund revenue shortfalls ; growing public dissatisfaction with current transportation system performance; an emerging consensus among a variety of policy experts; a legacy of wasteful projects; and an array of real world policy experiments around the globe.

With respect to immediate term federal surface transportation spending, there appears to be little doubt that prior to the end of the fiscal year, Congress will once again be forced to grapple with the fiscal reality of annually spending billions more than is collected through taxes. USDOT's inspector general Calvin Scovel summed it up when he said at recent Congressional hearing, "the bottom has fallen out of the highway trust fund." Given the state of the economy and recovery efforts, it would be economically unwise to raise gasoline or diesel taxes. This leaves limited options for 2009 beyond increasing the general fund contribution and/or reducing/slowing spending.

Going forward, however, the federal government has a unique opportunity to transform the nation's transportation investment strategy. This Committee could play a leadership role in that transformation if it so chooses. Over the past four plus years, the terms of the debate about transportation have fundamentally changed, and the transportation policy community has achieved a high degree of consensus about the need for major reform. That policy consensus has not yet translated into any sort of national political consensus, however. It is likely that that will only happen when Congress, the Administration and America's business leaders decide that major reform is necessary and subsequently agree on the implementation elements of such reform.

Before discussing specific ways to improve upon the country's or the federal government's current transportation finance strategies, it is critical that the problem be defined correctly. In fact, far too often, the transportation debate in the U.S. has been consumed by discussions about symptoms, not causes. The basic problems with the current strategy are described below. Each can be remedied through Congressional action, and each has direct bearing on the work of this Committee.

1) There is an under emphasis on quality as compared to quantity of investment.
A variety of economists have analyzed the social returns generated from highway investments in

recent years and each has concluded that we are getting less and less from our investments¹. In other words, a \$1 invested today is producing far less in the way of reduced congestion, improved safety and enhanced business productivity than a \$1 invested 30 years ago.

Some of this decline is the natural result of having an already massive transportation system. The earliest projects completed in the development of a new network are often the ones that deliver the most long-term benefits. However, there are strong reasons to conclude that other factors are at work in driving down societal returns. Most important among these is the lack of quantitative analysis in determining how to allocate transportation investment dollars and select projects at all levels of government. In the absence of this analysis, political forces, relationships and other non-economic considerations typically prevail.

Any successful capital intensive business in the private sector selects projects using some form of net present value and/or rate of return analysis. Projects that score poorly using these metrics are either shelved indefinitely or substantially modified. Unfortunately, the majority of surface transportation projects in the U.S. are pursued with little or no comparative economic analysis. The federal government requires that any federally funded highway or transit project navigate a labyrinth of complex process requirements prior to commencing construction. While these requirements do an excellent job of preventing rash decisions, they have done far too little to encourage productive and innovative investments. As a result, our current approach is often the worst of both worlds – lengthy and expensive processes without the productive outcomes that are supposed to attach to process-laden decisions. This perverse strategy is the natural result of poorly defined federal/state/local authority roles and responsibilities.

Why should this matter to Congress? Because resources are always limited (something this Committee probably appreciates more than any other), it is imperative that we understand with some degree of certainty what national investments can be expected to produce in the future. An annual national surface transportation investment of \$70 billion that produces a societal return of three percent per year will yield dramatically fewer overall public benefits than an investment of \$55 billion that produces an annual societal return of ten percent. Since these investments are intended to last many years, small differences will produce large disparities in results.

The national discussion regarding the “Bridge to Nowhere” has stimulated growing public hostility to wasteful federal earmarks, but it has not ushered in a nationwide consensus for an alternative investment approach with clearly defined criteria and rigorous post-investment analysis. In short, budget and policy are inextricably linked, and the timing is quite ripe for a major Congressional re-assessment of these programs.

2) Federal investments do not adequately leverage non-federal investments or promote system efficiencies. The federal government does not own or operate the vast majority

¹ Chad Shirley and Clifford Winston (2004), “Firm Inventory Behavior And The Returns From Highway Infrastructure Investments,” *Journal of Urban Economics*, Volume 55, Issue 2; Marlon G. Boarnet and Andrew F. Haughwout (2000), *Do Highways Matter? Evidence and Policy Implications of Highways’ Influence on Metropolitan Development*, Brookings; M.I. Nadri and T.P. Mamuneas (1996), *Contribution of Highway Capital to Industry and National Productivity Growth*, FHWA, USDOT; cited in USDOT (1997), *Transportation in the United States: A Review*, USDOT (<http://ntl.bts.gov/data/titustxt.pdf>)

of the nation's surface transportation systems. Instead, it contributes approximately 40% of highway and transit capital dollars and roughly 20% of all highway and transit dollars (figures vary from year to year). When the federal government invests, just as any other investor, it should have confidence that the owners and operators of the systems in which it invests have the right incentives. In other words, will the owner/operator efficiently design, capitalize, finance and manage the underlying assets?

With a few exceptions (the recently enacted stimulus legislation being prominent among them), current federal programs typically require minimum state or local funding matches and safety thresholds. These are broad-based regulatory requirements, however, not a targeted policy. What is badly lacking in the current framework is a specific focus on attracting capital from other sources that are likely to have better information and better incentives than the federal government. Thus, even if we were able to achieve federal reforms designed to increase investment returns on federal dollars as discussed above, we would still be missing an opportunity to specifically use those dollars as a means to generate investment interest from non-federal sources.

So, from the perspective of this Committee, the answer to the question of how much to spend at the federal level should vary depending on the degree to which such spending "crowds out" other spending or stimulates other spending. \$50 billion of federal spending that facilitates an additional \$80 billion in state, local and private sector spending should be considered differently than \$50 billion that facilitates \$150 billion in state, local and private sector spending. The former is the current policy, while the latter is achievable only with reforms. A 2004 GAO report that studied state and local spending in the last economic downturn found that, "in 2002, states and localities contributed 54 percent of the nation's capital investment in highways, while federal funds accounted for 46 percent. However, as state and local governments faced fiscal pressures and an economic downturn, their investment from 1998 through 2002 decreased by 4 percent in real terms, while the federal investment increased by 40 percent in real terms."²

There is little question that the federal program is underperforming when it comes to attracting capital from other sources, but it is also failing when it comes to promoting operational efficiencies. In fact, as currently constructed, the federal program is largely indifferent to how well surface transportation systems perform once they are constructed. With respect to the highway system, we have witnessed a precipitous decline in travel time performance (i.e. congestion) and reliability in the last 30 years. Contrary to media accounts, bridge safety and National Highway System pavement quality have actually improved modestly in the last 15 years.

Virtually every economist and independent transportation expert that has analyzed U.S. highway policy in the last 10 years has concluded that our highway system is badly mispriced (charges to system users are not linked to the true costs of travel) and that the current reliance on taxes (as opposed to direct user fees) is a chief culprit. The recently completed

² GAO-04-802, FEDERAL-AID HIGHWAYS, Trends, Effect on State Spending, and Options for Future Program Design

National Surface Transportation Infrastructure Financing Commission agreed with this assessment saying, “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.”

The just released Congressional Budget Office report entitled “Using Pricing to Reduce Traffic Congestion” identifies congestion pricing as “one fundamental way of improving efficiency” and recommends a variety of federal policy options to encourage state and local implementation. The USDOT’s 2006 Conditions and Performance Report for the first time attempted to model the costs to maintain current highway system conditions and performance if “universal” congestion pricing was implemented and found that costs would be reduced by a dramatic 27.5%.

The 2008 version of this report is expected to build substantially upon this analysis, and I would encourage the Committee to review its findings closely. In fact, there are few, if any, policy ideas that garner the support of the General Accountability Office, the Brookings Institute, the Washington Post and New York Times editorial pages, the Cato Institute, Environmental Defense, the National Resources Defense Council, the Reason Foundation, experts at USDOT and EPA and the President’s budget, among others. The best way to implement pricing and utilize corresponding revenues are indeed subjects of intense debate, but the degree of policy consensus that has emerged on this point in just the last three years is impressive.

Highway pricing strategies can be successfully integrated with transit investment and operational strategies, particularly in metropolitan areas. Because federal highways and transit programs are not integrated, our transit investments are typically made with little reference to highway policies or likely highway demand in the exact same corridor. For this and other reasons, a series of studies over the last 25 years have revealed a systematic underperformance in actual transit ridership relative to predicted ridership in the New Starts Program. In two Federal Transit Administration analyses conducted in the last six years, actual ridership for New Starts projects was 68.9% and 74.5% of forecasted ridership. In addition, the gap between revenues generated from passengers and total operating expenditures for U.S. transit systems more than doubled in nominal dollar terms from 1995 to 2006 according to the American Public Transportation Association *2008 Public Transportation Fact Book*.

Potential Responses

A variety of federal approaches relevant to this Committee are available to address these concerns in the context of the reauthorization of SAFETEA-LU, including:

- *reform existing programs to establish meaningful reward components for project sponsors that use federal grants to attract private investment and operate transportation systems more efficiently.* Over \$150 billion of global private equity infrastructure capital has been formed in recent years (in spite of a relatively de minimis level of federal statutory support). Hundreds of billions of dollars of debt capital are also available for U.S. infrastructure projects.

It is now apparent that if Congress established programs and policies favorable to this capital, those figures would grow dramatically. It is also clear that this and subsequent capital will find a home in counties with more receptive policies, including Europe, Asia, South America, Canada, Mexico and Africa. Through its formal partnerships with urban areas in 2007 and 2008, USDOT also demonstrated that small amounts of federal discretionary dollars provided powerful operational efficiency incentives for pioneering state and local officials.

Rewards could take the form of additional grants for other projects, ratings priority in competitive grant programs and increased programmatic/regulatory flexibility. A variety of federal tax code changes could also provide greater incentives for non-federal investment.

Specifically, the recently enacted stimulus package includes a new \$1.5 billion program with broad implementation discretion for the Secretary of Transportation. A strong policy case could be made that the Department should utilize these resources to develop major projects that leverage private capital, test innovative risk sharing procurement strategies and promote new technologies.

- *increase emphasis on federal loans and other credit assistance, not just grants.* In addition to leveraging non-federal investments, such an emphasis provides multiple additional benefits: 1) it encourages the utilization of user fees - a more efficient payment mechanism than gasoline taxes; 2) it is significantly less expensive to the federal taxpayer than pure grants; 3) it reduces the risk of “wasteful” projects since credit provision requires more public and private lender oversight of underlying project economics; and 4) it reduces the cost of capital for infrastructure projects relative to other capital investments. The Department’s TIFIA program could be greatly expanded in order to achieve these benefits.
- *reform the transportation planning process to ensure that economic criteria is fundamental in project and plan decisions.* Absent compelling circumstances, the highest rated project alternative (regardless of mode of transportation), using a present value of net benefits, should be pursued for all federally funded projects with project costs in excess of \$100 million. In addition, statewide and metropolitan transportation plans (required under federal law) should rank and disclose project lists using a net present value calculation.
- *clearly define the relative roles of the federal government, state government, local government/authority and the private sector.* Until the relative roles of the various entities involved in infrastructure finance are clearly defined, budget and policy outcomes will be sub-optimal. Today, the federal government attempts to be all things to all constituencies. A better approach would be to identify a more limited number of areas for federal focus and provide clear discretion and performance targets related to those roles.

- assess transportation “needs” (and budgetary requirements) more accurately by separating condition and performance. Both recently concluded national commissions assess our system “needs” by largely assuming that spending and new capacity are the only available response in the near term to ensure that current system performance is either maintained or improved. As was revealed in the 2006 Conditions and Performance Report described above, large improvements in performance can be achieved with efficient pricing and technology proposals, not simply capacity expansion. In turn, pricing will send a clear signal to governments and investors as to where capacity constraints are most economically important (as well as provide revenues for such expansion). Maintaining and improving physical conditions requires improved targeting of capital resources so that the highest return rehabilitation and preservation investments are made.

VMT Taxes

With the recent comments of Secretary LaHood, as well as the recommendations of the Financing Commission, the concept of a federally-imposed vehicle miles traveled tax (VMT) has received growing attention. Such a tax offers the policy advantage of revenue sustainability even as the light and heavy duty vehicle fleets become more fuel efficient (through market forces and expected regulations). A VMT tax also offers the policy potential of tailoring travel charges more specifically to costs. In this regard, a VMT tax could conceivably achieve revenue and congestion relief policy objectives simultaneously.

However, from a policy perspective, a federally-imposed flat fee VMT may not be materially superior to a gasoline tax. In fact, even though the focus has been on revenue generation, the majority of benefits from such a system would come from the ability to differentiate charges more efficiently than traditional gas/diesel taxes. A driver who drives 90 miles on an uncongested rural interstate in a Volkswagen Jetta is imposing close to zero marginal costs on the transportation system or other transportation users. Another Jetta driver that travels 3 miles at 8:30 am on the Capital Beltway here in Washington, DC is often imposing more than \$2.00 in costs on other drivers. Under a flat VMT regime, the first Jetta driver may pay 20 times more (depending on the charge) than the second Jetta driver. To the extent the system does not adjust for this mispricing, the transition and administrative costs are likely to overwhelm the incremental benefits the VMT may enjoy over gas/diesel taxes at the federal level (to say nothing of the political complexities associated with the federal government administering the charge). An additional research area related to the VMT tax that deserves more attention is its impact on fatality rates.

Regardless of one’s views of the VMT tax in the future, a more aggressive deployment of current pricing technologies will achieve many of the theoretical benefits of a VMT tax in the near term. The technical sophistication of “open road” electronic tolling has advanced greatly in the last 10 years, even as implementation costs are declining. Just months following procurement, roads can be outfitted with sophisticated pricing technologies that provide powerful new speed and reliability choices for drivers. Almost 20 different metropolitan areas in the U.S. are developing projects today using readily available technologies. While the

federal government is not the revenue collector in these projects, targeted federal assistance is proving crucial.

Conclusion

Meaningful reforms to our country's transportation finance policies will not come about easily or instantly. Clear leadership from Congress and the Obama Administration, backed by a growing body of policy research and an emerging bipartisan policy consensus, can move the debate from one focused on theory to one focused on real world implementation. Budget and policy are inextricably linked in this effort. Spending more without a coherent investment strategy and without clear policy objectives will be a largely fruitless endeavor.