



Testimony

of the

American Road and Transportation Builders Association

before the

**Subcommittee on Highways and Transit of the Committee
on Transportation and Infrastructure**

On

**“Structure of the Federal Fuel Tax and the Long-Term
Viability of the Highway Trust Fund”**

Tuesday, March 27, 2007

By

**William R. Buechner, Ph.D.,
Vice President, Economics and Research**

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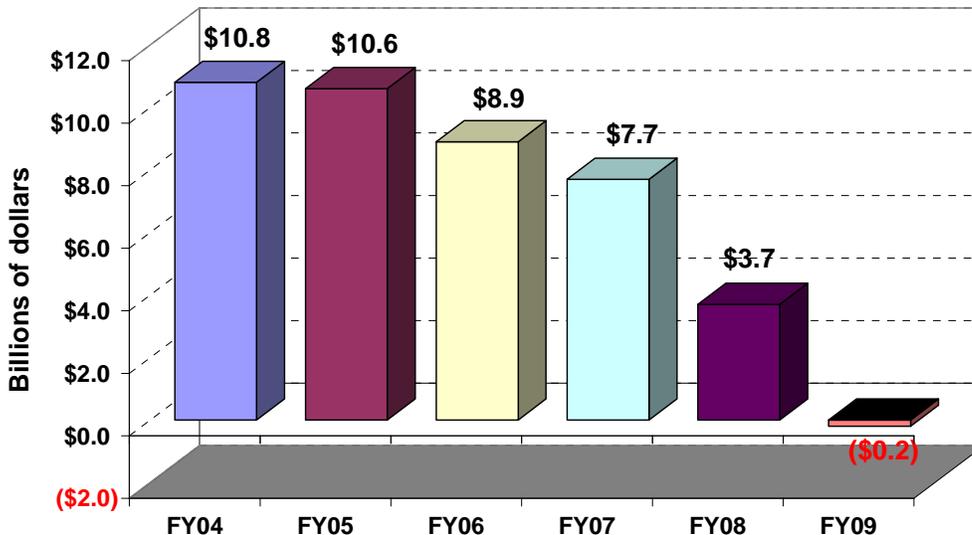
Mr. Chairman and members of the Subcommittee, thank you very much for inviting the American Road and Transportation Builders Association (ARTBA) to present its views on the viability of the federal motor fuels excise tax as a primary revenue source for the federal Highway Trust Fund (HTF).

Highway Trust Fund Balance

Before discussing this issue, let me address a more immediate concern—the projected elimination of the cash balance in the Highway Account of the Highway Trust Fund.

According to the Federal Highway Administration, the cash balance in the Highway Account will fall slightly below zero by the end of FY 2009, as shown in Figure 1. This forecast assumes Congress concurs with the recommendation in the president’s budget not to fund the \$631 million RABA bonus for FY 2008. If Congress does fund the RABA bonus, as provided in Section 8002 of the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU), the negative balance at the end of FY 2009 would be slightly larger, about -\$700 million.

**Fig. 1 - Highway Account Balance Projected to Fall to
-\$200 Million by End of FY 2009**



Source: Federal Highway Administration

This situation has been characterized as “bankruptcy of the trust fund,” which implies some impending disaster for the federal highway program. But the term “bankruptcy” overstates the impact of a negative Highway Account balance. The FHWA forecast simply means that projected outlays from the Highway Account in FY 2009 will be slightly larger than the amount of funds available during FY 2009. But there will still be plenty of money coming into the Highway Account after FY 2009 to cover the shortfall. In fact, during the following four fiscal years, Highway Account revenues are projected to exceed \$150 billion.

So, if a \$200 - \$700 million shortfall in the Highway Account does materialize as projected, all Congress would have to do is enact a small amount of additional revenues in FY 2009 to close the gap.

An effective solution to this problem would be to repeal or restructure most of the remaining exemptions from the federal motor fuels excise taxes. According to the Joint Committee on Taxation, Highway Trust Fund Highway Account exemptions are provided for:

- Use in State and local government and nonprofit educational organization highway vehicles;
- Use in buses engaged in transporting students and employees of schools;
- Use in private local mass transit buses having a seating capacity of at least 20 adults (not including the driver) when the buses operate under contract with (or are subsidized by) a State or local government unit to furnish transportation; and
- Use in private intercity buses serving the general public along scheduled routes. Such use is totally exempt from the gasoline excise tax and is exempt from 17 cents per gallon of the diesel fuel tax.

Exemptions and reduced rates for the annual use tax that is imposed on heavy highway vehicles are provided for certain “transit-type buses,” trucks used for fewer than 5,000 miles on public highways (7,500 miles for agricultural vehicles), and logging trucks.

The U.S. Department of Treasury testified to the House Transportation and Infrastructure Committee in 2006 that these exemptions cost the Highway Trust Fund Highway Account approximately \$1 billion per year in foregone revenue. There are no comparable exemptions for contributions to the Mass Transit Account.

Eliminating these Highway Account exemptions would likely ensure the trust fund has enough revenue to meet the investment commitments made in SAFETEA-LU and would prevent the next reauthorization cycle from starting in a deficit situation.

The policy rationale behind the Highway Account exemptions is not related to improving the nation’s transportation infrastructure. With the Highway Account facing a projected negative balance, these exemptions can no longer be afforded. The exemptions should either be repealed or restructured as a general fund supported activity, as was done to eliminate the adverse impact of the ethanol motor fuels tax treatment on Highway Account revenues in 2004.

Even with this change, there is no question that projected Highway Account revenues will not be able to support continued funding for the federal highway program at the SAFETEA-LU level after FY 2009. The cash balance in the Highway Account at the start of FY 2010 will effectively be zero, even if it does not go negative. There will be no cash reserve to support a highway program after FY 2009 where outlays continue to exceed Highway Account revenues.

The Treasury Department projects Highway Account revenues of just over \$37 billion in FY 2010. Much of the revenue—\$30 billion or more—will be needed to finance outlays resulting from funding provided by SAFETEA-LU. This means only \$6-\$7 billion of the FY 2010 Highway Account revenues will be available to support new federal highway investment in FY 2010. Given that 27 percent of highway program funds spend out during the initial fiscal year, \$6-\$7 billion of available revenues would support no more than \$24-\$25 billion of federal highway investment in FY 2010. This would be a cut of about \$18 billion from the \$42 billion of guaranteed funding for FY 2009 under SAFETEA-LU.

User Fee Financing for the Highway and Mass Transit Programs

This brings us to the core issue of this hearing—whether the current federal motor fuels tax is the appropriate model to general funds for the federal highway and mass transit programs for the next reauthorization bill and how much longer the federal motor fuels excise tax can serve as a major source of revenues to finance the federal surface transportation programs.

This is an extremely important question, because of its impact on the fundamental principle of user fee financing for the federal transportation program. User fee financing of the federal highway and transit programs through the motor fuels tax has proven to be good public policy for two reasons. First, it relieves the federal general fund of responsibility for financing those important investments. Highway investment benefits highway users and they are the ones who pay for it. In return, the motor fuels excise tax has provided steady reliable support for federal highway investment for more than 50 years.

A federal tax on gasoline was first enacted in 1932. Until creation of the Highway Trust Fund in 1956, federal gas tax revenues were credited to the general fund. Federal investment in highways was financed from the general fund, but there was no specific relationship to gas tax revenues.

Since 1956, revenues from the federal excise tax on motor fuels have been deposited into the federal Highway Trust Fund where they have, at least in theory, been used to support federal highway investment and, since 1982, federal investment in mass transit.

The current federal excise tax on gasoline and gasohol is 18.3 cents per gallon. The tax on diesel fuel is 24.3 cents per gallon. Both apply only to motor fuels used for on-highway travel. The tax is paid to the Treasury by wholesale distributors of motor fuels and is passed on to highway users who pay it as part of the price of gasoline and diesel fuel at the pump.

Of the total tax per gallon, 2.86 cents for both gasoline and diesel fuel is credited to the Mass Transit Account of the Highway Trust Fund and is used to finance the federal public transportation program.

The remainder—15.44 cents per gallon of the tax on gasoline and gasohol and 21.44 cents per gallon of the tax on diesel fuel—is credited to the Highway Account to finance the federal highway program.

The only other revenue source for the HTF is a set of taxes levied on heavy trucks, in the form of sales, use, and heavy tire taxes which are credited to the Highway Account.

In FY 2007, motor fuel taxes are projected to generate \$34.4 billion, or 87 percent of HTF revenues. The truck taxes are expected to generate \$5.5 billion, or 13 percent. The U.S. Treasury projects annual growth of Highway Account revenues of just under \$1 billion for the next few years.

Outlook for the Federal Motor Fuel Excise Tax

Looking to the future, our concern is whether there is anything on the horizon that would pose an obstacle to the continued use of motor fuel taxes as the major source of financing for the Highway Trust Fund. To do this, we have to look at factors that might erode the tax base or the tax rate.

Tax Base. When we are talking about erosion of the tax base, we mean anything that might reduce the highway use of gasoline and diesel fuel. Let me address the potential threats:

- CAFE standards. The most imminent concern is the proposal to raise corporate average fleet economy (CAFE) standards for cars and light trucks. An increase in fuel economy means less fuel will be needed for highway travel and thus less fuel tax revenues for the Highway Trust Fund.

But this should not pose a measurable threat to the flow of motor fuel tax revenues for SAFETEA-LU reauthorization. The only CAFE changes actually announced to date apply to light trucks and would not be fully implemented until the 2011 model year, which coincides with the start of federal FY 2012. The Bush administration has also made a proposal that would take years to enact and implement.

Even when the new CAFE standards are implemented, it will be a number of years before light trucks conforming to the standards comprise a significant part of the car and light truck fleet. Currently, there are more than 230 million cars and light trucks registered in the U.S. New car and light truck sales have averaged around 16 million vehicles in recent years, or about 7 percent of the total. At a turnover of 7 percent per year, it takes more than 14 years to completely replace the entire car and light truck fleet. Based on the projected CAFE increase and the vehicle turnover rate, the potential impact of the new light truck standards would be about three-tenths of one

percent starting 2012 or just about \$100 million per year. By 2015, HA motor fuel tax revenues would be about \$300 million lower than under current CAFÉ standards. Furthermore, even if higher CAFÉ standards reduce fuel consumption, the revenue effect can be offset by raising the tax rate.

- Rising retail prices for motor fuels. Even without higher CAFÉ standards, rising fuel costs would probably have a similar effect. No-one can predict the price of gasoline or diesel fuel from month to month or year to year, but it is virtually inevitable that the price of gasoline and diesel fuel will trend upward in the in the long term. Rapid growth of car ownership in China and India will increase demand while the cost of developing new petroleum supplies gets larger and larger. As prices rise, consumers will adjust by reducing travel and purchasing more fuel-efficient vehicles. This is a long-term adjustment that, absent a crisis like 1973 or 1979, should have little impact on revenues for SAFETEA-LU reauthorization.
- New motor fuels. As petroleum becomes scarcer, there will be pressure to develop new fuels for cars and trucks. Taxation, however, should not be a problem so long as the fuel requires a special delivery system to highway users. This would apply to ethanol, biomass diesel, hydrogen and compressed natural gas, all of which are or could be taxed somewhere in the delivery system at a rate equivalent to that on gasoline and diesel fuel. The main potential problem is electric vehicles but that is far in the future.

Construction Costs and Purchasing Power of the Federal Motor Fuels Tax. Far more important for both SAFETEA-LU reauthorization and the longer term is the erosion of the purchasing power of the federal motor fuel tax rates.

Congress last adjusted the federal motor fuel tax rates in 1993, when the gasoline tax was increased 4.3 cents from 14.0 cents per gallon to the current rate of 18.3 cents per gallon. The tax rate on diesel fuel was also raised by 4.3 cents per gallon at that time. That was 14 years ago and there have been no further adjustments.

What has happened to the purchasing power of the federal motor fuels tax since then?

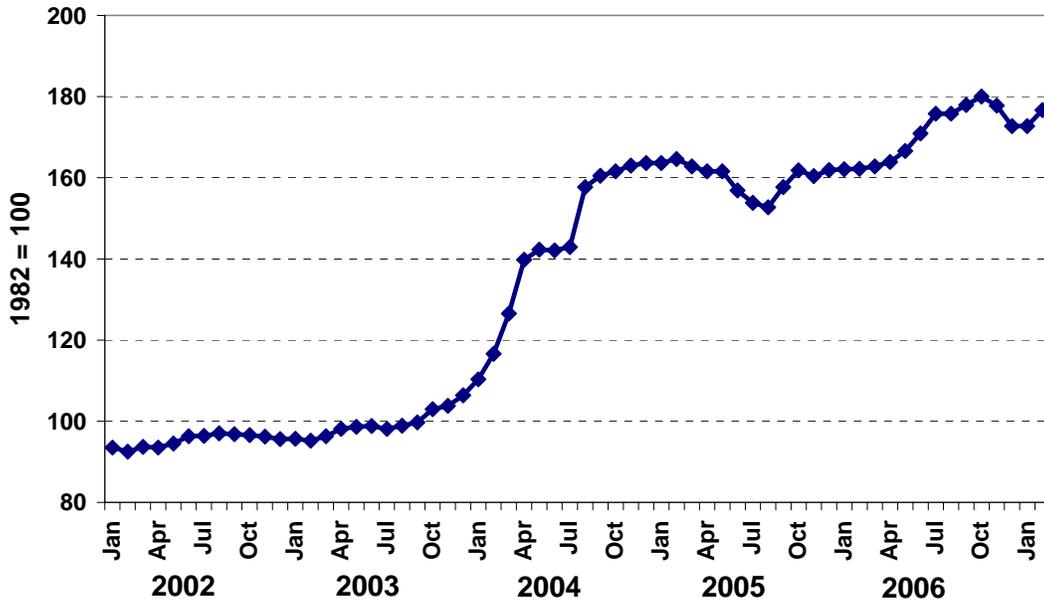
There is, unfortunately, no comprehensive official price index that applies to the cost of constructing highways and bridges. The best alternative is the Producer Price Index for Highways and Streets, which is prepared and released monthly by the U.S. Bureau of Labor Statistics, an agency of the U.S. Department of Labor. This index tracks the prices of all materials and services that are used directly or indirectly for highway and bridge construction.

This index shows that between 1993 and 2003, the cost of constructing highway and bridges rose moderately each year, tracking close to the Consumer Price Index. Even with moderate inflation, the purchasing power of the federal gasoline tax fell 25 percent in that one decade.

This relative stability came to an end in 2004. In the spring of that year, the price of construction steel began to rise rapidly due to Chinese purchases of scrap steel from around

the world to use for their construction projects. Scrap is a major source of raw materials for the U.S. steel industry. As the supply of scrap fell and prices skyrocketed, the availability and price of steel used in highway and bridge projects became a major problem. Figure 2 shows the rapid price increase for steel in 2004. Although the steel price index leveled off toward the end of the year, it was at a much higher level than in 2003.

Fig. 2 - Cost of Construction Steel Almost Doubled in 2004

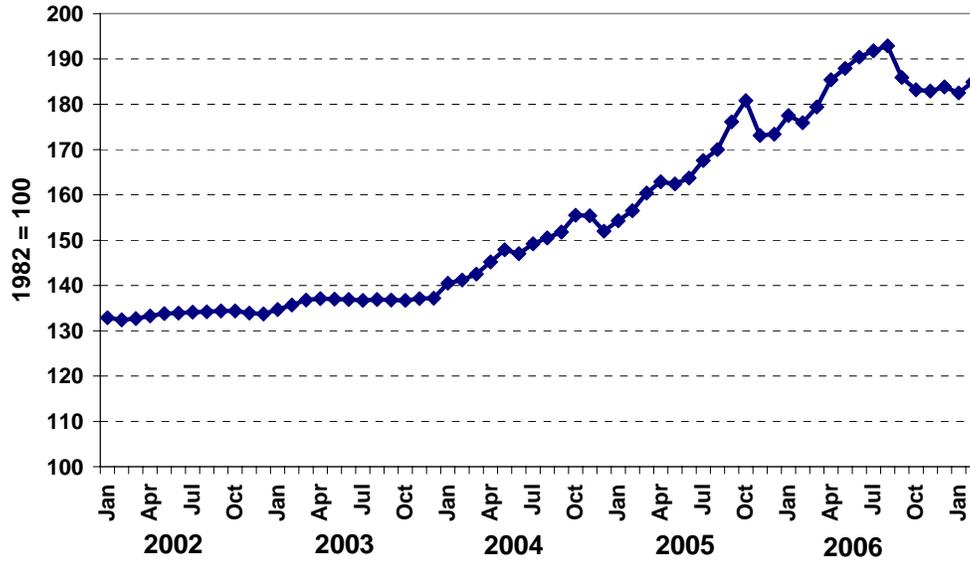


In 2005 and 2006, rapid price increases spread to core highway construction materials, including crushed stone, ready mix concrete, asphalt paving mixtures and diesel fuel, as shown in Figures 2a – 2d that are attached to the end of this statement. The causes were numerous, including: strong construction markets in the U.S. and around the world, which put pressure on supplies; Hurricane Katrina, which absorbed materials for emergency repairs; and spikes in petroleum prices, which worked into prices for asphalt and diesel fuel.

These increases in core highway construction materials as well as numerous other highway construction materials are incorporated into an overall index of highway and bridge construction costs, shown in Figure 3.

For the last three years, then, highway construction costs have risen substantially—8.5 percent in 2004, 12.5 percent in 2005 and 10.8 percent in 2006. During 2006, the average cost of highway construction materials was 35.2 percent higher than in 2003.

Fig. 3 - Cost of Highway Construction Materials Has Risen 35 Percent in Three Years



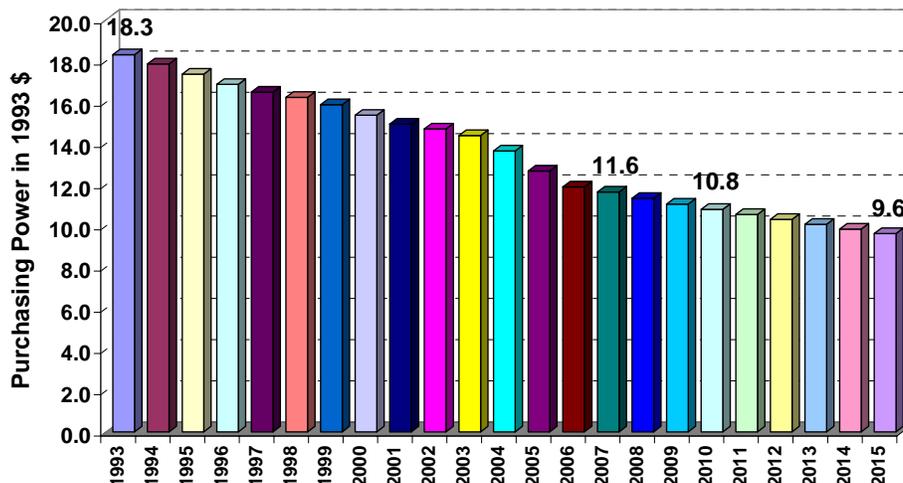
Source: Bureau of Labor Statistics. PPI for Highway and Street Construction

Fortunately, materials like asphalt and concrete comprise only half the cost of constructing highway and bridge projects, on average. According to reports submitted to the FHWA by highway contractors, labor and overhead such as office rental, equipment, medical insurance and phone bills comprise the other half of construction costs—and these have been rising at a much lower rate.

When all of these factors are combined, ARTBA calculates that the cost of highway and bridge construction in 2006 was at least 20 percent higher than in 2003. In parts of the country, the increase may have been much higher.

The relative purchasing power of the federal gasoline tax each year from 1993 to 2015 is shown in Figure 4. The Consumer Price Index is used as the measure of highway construction

Fig. 4 - Purchasing Power of Federal Gas Tax Being Eroded by Rising Highway Construction Costs



Source: BLS CPI thru 2003; ARTBA estimate for 2004-06; FY 2008 Budget of the U.S. Government for 2007 forward

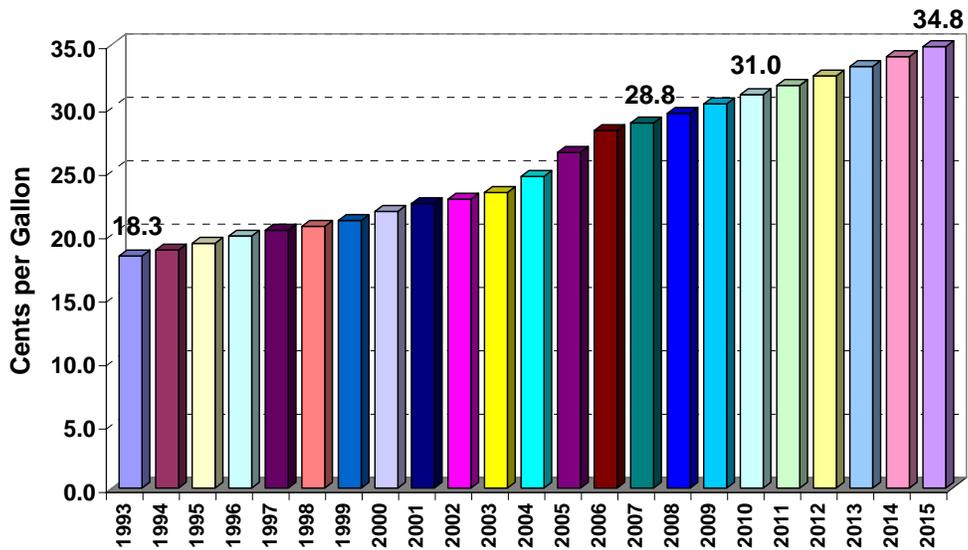
costs for all years except 2004-06, where we incorporate our best estimate of the actual increase.

As the chart shows, the federal gas tax today buys less than 2/3 the amount of highway and bridge construction as in 1993. It is as though the gas tax today were 11.6 cents per gallon.

By 2010, the first year of the next surface transportation authorization bill, the purchasing power of the gas tax is likely to fall even further, to 10.8 cents per gallon. By 2015, the 18.3 cent per gallon gas tax will purchase only 9.6 cents worth of highway construction.

Figure 5 shows what the federal gas tax rate should have been, or should be, each year to maintain the same purchasing power as 18.3 cents per gallon in 1993. In 2007, for example, the tax rate would have to be 28.8 cents per gallon. By 2015, we would need 34.8 cents per gallon.

Fig. 5 - Gas Tax Rate Required to Maintain 1993 Purchasing Power of 18.3 Cents per Gallon



Source: Same as for Figure 4

In conclusion, the federal motor fuels tax should continue to serve as a primary source of funding for federal highway investment, both for SAFETEA-LU reauthorization in the short run and probably for some time after that. For more than 50 years, the federal surface transportation programs have operated on the “users pay” principle. This principle has served the nation well. It has removed the responsibility for financing federal highway and transit investment from general taxes while providing a steady and secure source of funding for highway and transit improvements. Foreign transportation officials visiting ARTBA invariably express their envy for our system and wish for a similar source of dedicated revenues.

SAFETEA-LU Reauthorization

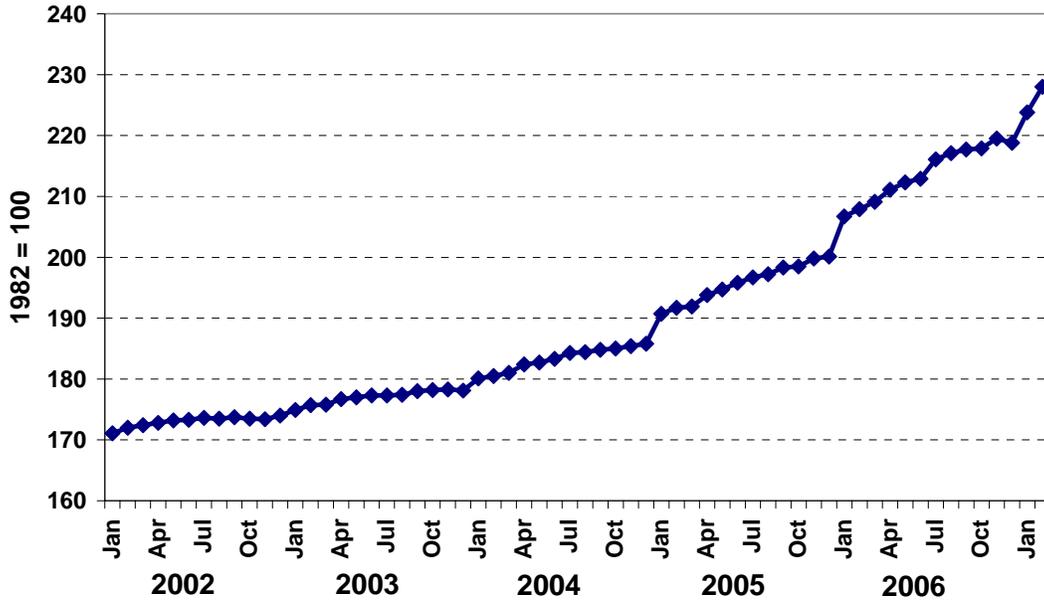
I want to caution that the increase in the federal gas tax to maintain its 1993 purchasing power is only a benchmark, not a policy recommendation. To ask, for SAFETEA-LU reauthorization, how much the gas tax should be increased to restore its 1993 purchasing power is the wrong question and goes at the financing issue backwards.

The way Congress should approach this for the next surface transportation bill is to start with establishing our highway and transit investment vision and needs for the six years from FY 2010 through FY 2015 and beyond. What amount should the federal government invest to maintain and improve our highway and transit systems so that they support the economic growth and mobility goals for this country? Once we know what we must accomplish through the federal surface transportation program, then Congress can determine how that investment should be structured and financed and the revenues to be raised.

That is the subject of another hearing and ARTBA would be pleased to present its views at the request of the Committee.

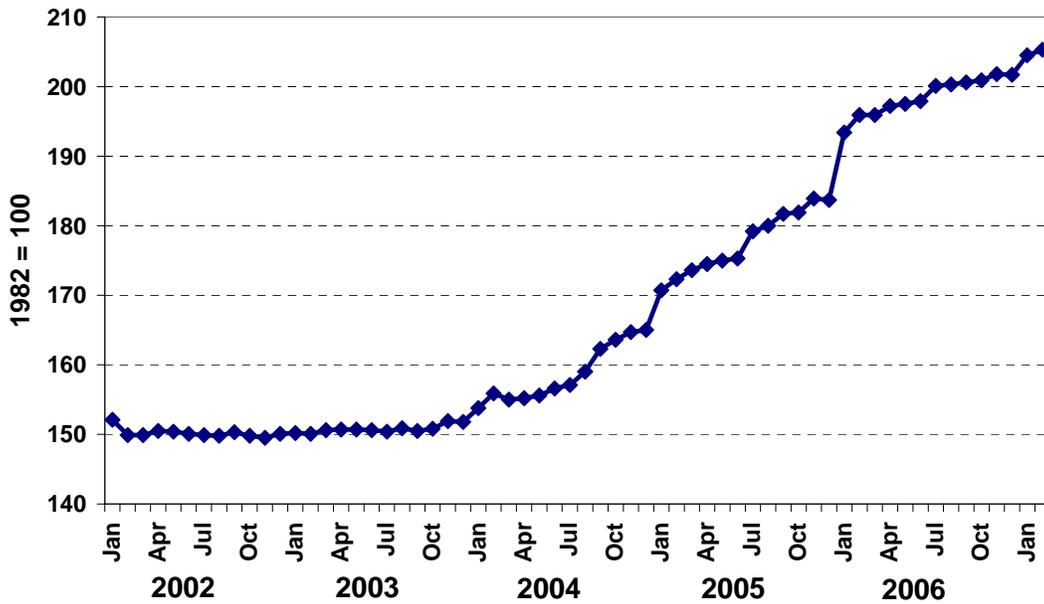
Mr. Chairman, again I thank you for the opportunity to testify on this issue. I would be happy to respond to questions.

Fig. 2a - Cost of Construction Sand, Gravel and Crushed Stone Has Risen 20.8 Percent Since 2003



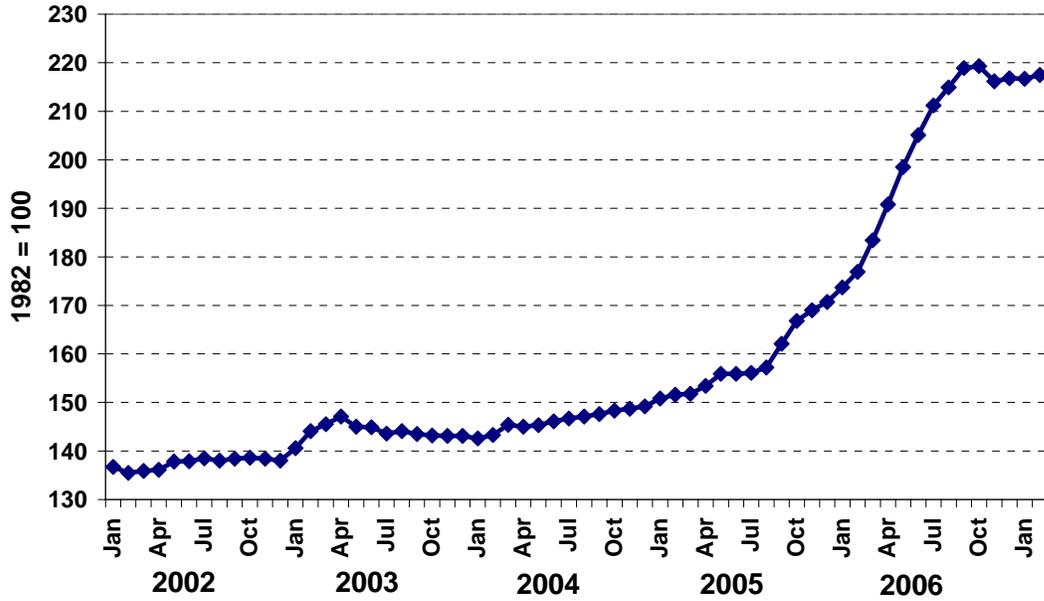
Source: Bureau of Labor Statistics. PPI for Construction Sand, Gravel and Crushed Stone

Fig. 2b - Cost of Ready-Mix Concrete Has Risen 31.7 Percent Since 2003



Source: Bureau of Labor Statistics. PPI for Ready-Mix Concrete

**Fig. 2c - Cost of Asphalt Paving Mixtures Has Risen
40.4 Percent Since 2003**



Source: Bureau of Labor Statistics. PPI for Asphalt Paving Mixtures

**Fig. 2d - Cost of Diesel Fuel Has Risen
115.9 Percent Since 2003**



Source: Bureau of Labor Statistics. PPI for #2 Diesel Fuel