



U.S. House of Representatives
Committee on Transportation and Infrastructure
Washington, DC 20515

James L. Oberstar
Chairman

John L. Mica
Ranking Republican Member

David Heymsfeld, Chief of Staff
Ward W. McCarragher, Chief Counsel

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James W. Coon II, Republican Chief of Staff

SUMMARY OF SUBJECT MATTER

TO: Members of the Subcommittee on Highways and Transit

FROM: Subcommittee on Highways and Transit Staff

SUBJECT: Hearing on "Structure of the Federal Fuel Tax and the Long-Term Viability of the Highway Trust Fund"

PURPOSE OF HEARING

The Subcommittee on Highways and Transit is scheduled to meet on Tuesday, March 27, 2007, at 2:00 p.m., to receive testimony on the structure of the federal excise tax on motor fuels, which generates the vast majority of the revenues that are deposited into the federal Highway Trust Fund. The hearing will examine how this tax structure affects the long-term financial viability of the Highway Trust Fund, which contributes most of the funding for the federal highway and transit programs. This will be the first in a series of hearings on financing investment in our surface transportation infrastructure. The Subcommittee will hear from the Deputy Director of the Congressional Budget Office (CBO), an economist from the transportation construction industry, and transportation experts in the research community.

BACKGROUND

Federal-Aid Highway Program

The Federal-Aid Highway Program (Federal highway program) is a federally-assisted, state-run program in which the states plan, design, and construct highway projects as well as operate and maintain major roads. A primary role of the federal government is to provide financial resources and technical assistance to state departments of transportation to construct, preserve, and improve the National Highway System and other urban and rural roads that are eligible for federal assistance although they are not part of the System.

There are nearly four million miles of public roads in the United States, but only about 965,000 miles of these roads are in the National Highway System. Governments at all levels provided \$147.5 billion in 2004 for highways and bridges in the form of capital outlay, maintenance and operations, highway safety and enforcement, and debt service. Federal investment of \$33.1 billion in that year accounted for 22.4 percent of the total.

Federal assistance for highway construction dates back to the early 20th century when Congress provided \$500,000 in the Post Office Appropriations Bill of 1912. A greatly expanded federal role began with the Federal-Aid Highway Act of 1944, which authorized the construction of a "National System of Interstate Highways." The construction program did not get off to a good start due to, among other things, the lack of a sound financing mechanism.

The landmark Federal-Aid Highway Act of 1956 authorized a 41,000-mile National System of Interstate and Defense Highways and established the Highway Trust Fund (HTF). Receipts from federal excise taxes levied on motor fuels and various highway-related products such as tires and heavy vehicles are deposited into the HTF to be used to finance the Federal highway program. The motor fuel tax is the most important among the various excise taxes, as it provides about 90 percent of all HTF revenues. This dedicated funding mechanism provides financial certainty for the Federal highway program.

Federal Public Transportation Program

The federal public transportation, or transit, program is a federally-assisted and administered program. Federal transit assistance comes in the form of grants. To obtain assistance, a grant applicant (publicly-owned operators of transit systems, local governments including metropolitan planning organizations, states, and Indian tribes) must submit an application to the Federal Transit Administration. When the grant is approved, federal funds are obligated to enable the agency to proceed with its procurement process or receive reimbursement for expenditures that have already been made.

In 2004, there were 640 transit operators serving urbanized areas, of which 600 were public agencies. These agencies operated 120,659 vehicles, 57 percent of which were buses and 92,520 of which were in areas with more than one million people. Rail systems comprised 10,892 miles of track and 2,961 stations. There were 793 bus and rail maintenance facilities in urban areas with more than 5,000 people. The most recent data (for the year 2000) show there were 19,185 transit vehicles operating in rural areas with population below 5,000 people. Americans took 10.1 billion trips on public transportation in 2006, the highest transit ridership in 49 years.

Federal assistance for public transportation was first authorized in the Urban Mass Transportation Act of 1964. Congress recognized that the movement of people and goods was being jeopardized by the deterioration or inadequate provision of public transportation facilities and services, and set the stage for the current program of financial assistance for public transportation. The Federal-Aid Highway Act of 1973 for the first time allowed highway funds to be used for transit capital purchases. At that time, passenger fares accounted for about one-third of the average system's operating funds, and demand for dedicated federal assistance was high.

Since 1982, a portion of the fuel tax revenue has been deposited into the Mass Transit Account of the HTF to fund public transportation projects. Federal transit programs are funded

mostly with revenues in the Mass Transit Account (81 percent). The remainder of funding for public transportation programs comes from general revenues.

Highway Safety Programs

In addition to the Federal-aid Highway Program and the federal transit programs, the HTF also funds programs administered by the Federal Motor Carrier Safety Administration (FMCSA) and some of the programs administered by the National Highway Traffic Safety Administration (NHTSA). FMCSA oversees large truck and bus safety and the agency's programs are entirely funded by HTF revenues. NHTSA oversees highway and passenger vehicle safety. The agency's operational programs and research related to driver behavior are funded out of the HTF, while those geared particularly to the safety of vehicles are traditionally funded out of general revenues.

Changing Structure of the Federal Fuel Tax

When the HTF was established in 1956, the excise tax rate for highway use of motor fuels was three cents per gallon. Since then, the tax rate and structure have been revised several times. The current rates of 18.4 cents per gallon of gasoline and 24.4 cents per gallon of diesel went into effect on October 1, 1993.

Until 1982, all receipts from the motor fuel tax were deposited into the HTF. The Surface Transportation Assistance Act of 1982 increased the tax rate from four cents per gallon to nine cents per gallon, established separate accounts for highways and transit within the HTF, a Highway Account and a Mass Transit Account. One cent of the nine cents per gallon was deposited into the Mass Transit Account.

The Deficit Reduction Act of 1984 established differentiated rates for gasoline, used primarily by passenger cars, and diesel, used mostly by commercial trucks. This Act also raised the fuel tax rate for diesel by six cents to account for the additional wear to highway pavement caused by heavy trucks. The six-cent differential between gasoline and diesel has remained in place ever since.

The Superfund Amendments and Reauthorization Act of 1986 raised the rates by 0.1 cent per gallon to 9.1 cents per gallon of gasoline and 15.1 cents per gallon of diesel, and deposited the revenues generated from that increase into the newly-established Leaking Underground Storage Tank Trust Fund. The Omnibus Budget Reconciliation Act of 1990 allowed the increase to lapse on September 30, 1996.

The Omnibus Budget Reconciliation Act of 1990 raised the fuel tax rates by 5 cents per gallon to 14.1 cents per gallon of gasoline and 20.1 cents per gallon of diesel. But for the first time a portion of the tax revenue, 2.5 cents per gallon, was put into the general fund for deficit reduction. Revenues from that 2.5 cent per gallon tax were restored to the HTF on October 1, 1995.

The Omnibus Budget Reconciliation Act of 1993 raised the fuel tax rates by another 4.3 cents per gallon, and deposited all the receipts from that increase into the general fund for deficit reduction. The Taxpayer Relief Act of 1997 redirected the receipts from the 4.3 cents per gallon rate hike back to the HTF (80 percent to the Highway Account, and 20 percent to the Mass Transit

Account). The Act also reinstated the lapsed 0.1 cent per gallon fuel taxes for the Leaking Underground Storage Tank Trust Fund.

Currently, of the 18.4 cents per gallon federal excise tax on gasoline, 15.44 cents is deposited into the Highway Account, and 2.86 cents is deposited into the Mass Transit Account. Of the 24.4 cents per gallon federal excise tax on diesel, 21.44 cents is deposited into the Highway Account, and 2.86 cents is deposited into the Mass Transit Account. The latest data show that HTF receipts totaled \$38.8 billion in FY 2006, with \$33.9 billion deposited into the Highway Account, and \$4.9 billion into the Mass Transit Account.

Structural Weakness of the Federal Fuel Tax

One inherent weakness of the federal fuel excise tax is that it is a unit tax whose rate is tied to a gallon of fuel (gasoline, diesel, or other special fuels) consumed, as opposed to an *ad valorem* tax levied per dollar spent on fuel or a distance tax charged per mile of travel. The disadvantage of a unit tax is that revenues can grow only if consumption increases.

Rising fuel prices do not enhance HTF revenues. On the contrary, when the price of fuel rises beyond a certain point or when the price increase is viewed as permanent, highway users may curtail their driving and reduce their fuel consumption that would, in turn, depress HTF receipts. Indeed, a recent survey shows that the high prices of fuel last year resulted in reduced driving (as measured by total vehicle-miles driven).

Growth in fuel consumption is constrained by improving fuel efficiency of the vehicle fleet on our highways. In spite of the popularity of larger vehicles such as SUVs that use more fuel, the average fuel efficiency of our fleet has been increasing slowly and steadily since 1970, partly in response to policy initiatives including the corporate average fuel economy (CAFE) standards.¹ In 1970, the average passenger car got 13.5 miles per gallon. That average rose 62.2 percent to 22.3 miles per gallon in 2003, an average annual improvement of 1.5 percent. For light trucks, which include minivans, light pickup trucks, and smaller SUVs, the average fuel economy improved by 77 percent from 10.0 miles per gallon in 1970 to 17.7 miles per gallon in 2003, or 1.6 percent per year. Improving fuel economy means that less fuel is consumed per mile traveled, and less tax is paid into the HTF.²

The situation is made more difficult by the erosion of purchasing power of fuel tax revenues caused by inflation. Since the fuel tax rates were last raised in 1993, inflation as measured by the consumer price index (CPI) has risen by 28 percent. To maintain the value of tax revenues in real terms, federal fuel tax for gasoline should have gone up by 5.2 cents per gallon to 23.6 cents per

¹ CAFE standards do not apply to heavy trucks. For heavy single unit trucks including large pickup trucks and SUVs, fuel economy only went up from 6.8 miles per gallon in 1970 to 7.3 miles per gallon in 2003 for an average annual increase of 0.22 percent in the 33-year period. Fuel efficiency improvement for semi trucks fared equally poorly—they got 4.8 miles per gallon in 1970 and 5.1 miles per gallon in 2003, for an average annual fuel economy improvement of 0.19 percent. Indeed, the average fuel economy improvement for the period 1993-2003 was -1.3 percent per year.

² According to Federal Highway Administration (FHWA) data, a gap developed in the mid-1970s following the oil crisis of 1973-74 between vehicle highway travel and fuel use. Since then, the gap has been widening steadily. FHWA estimates that had that gap not developed (and the quantity of fuel use continued to grow in historic proportion with the amount of vehicle travel) motorists would be consuming about 70 billion gallons more fuel a year by 2005.

gallon and 29.6 cents per gallon for diesel.³ The problem actually has been more severe than reflected by the CPI data. The cost of building highway and transit facilities has risen dramatically, having registered almost a ten-fold increase on the construction cost index between 1957 and 2006. Since 2004, construction material prices have spiked as global demand for construction material skyrocketed due to rapid economic growth in many parts of the world, especially China and India.

The federal motor fuel excise tax rates must be increased periodically if the revenues the tax generates are to keep pace with rapidly rising travel demand and construction costs. However, such rates are established by law and were not raised during enactment of the Transportation Equity Act for the 21st Century (TEA 21) in 1998 or the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) in 2005.

Financial Viability of the HTF

Total vehicle miles traveled grew, on average, 4.9 percent between 1970 and 2003. More recently, total vehicle-miles traveled rose at an average annual rate of 2.3 percent between 1995 and 2004. Americans traveled nearly 3 trillion vehicle miles in 2004. To address pressing surface transportation investment needs, Congress significantly increased the authorization levels for the federal highway and transit programs in TEA 21 and SAFETEA-LU, often greater than the level of incoming HTF revenues.⁴ That has caused the cash balances in the Highway Account of the HTF to decline steadily.⁵ At the end of FY 2000, the Highway Account had a balance of \$22.55 billion. By the time TEA 21 expired at the end of FY 2003, the balance had fallen to \$13 billion. At the end of FY 2006, the balance in the Highway Account had dropped further to \$9.2 billion. Current projections by the Department of the Treasury and CBO estimate that the cash balances of the Highway Account will be depleted sometime in 2009.

If the Highway Account were to reach a zero balance in 2009, it would not mean that the Federal-Aid Highway Program runs out of money, as federal excise tax revenues will continue to flow into the HTF. However, it might mean that the level of investment would have to be cut back to levels below those authorized by SAFETEA-LU. Since those levels of investment are already insufficient to finance all the infrastructure needs required to support our changing economy, any reduction will have a detrimental impact upon our effort to improve the conditions and performance of our highways.

Most observers recognize that the current financing mechanism, which uses dedicated federal highway-related excise tax revenues to fund infrastructure programs and projects, though imperfect, has served the nation well in helping build a world class highway system and will continue

³ The 28.8 cents per gallon rate for diesel would maintain the 6-cent per gallon differential in tax rates between gasoline and diesel. Had inflation been factored in for diesel, the tax rate would have increased by 6.8 cents to 31.2 cents per gallon.

⁴ Since 2000, expenditures for federal highway programs have exceeded revenues credited to the Highway Account. This was possible because there were substantial cash balances built up in the Highway Account in the past. Both TEA 21 and SAFETEA-LU attempted to bring down the cash balances and to align authorized investment levels with anticipated revenues into the HTF. Federal highway programs are funded exclusively by HTF revenues; their funding levels are limited by available revenues in the Highway Account.

⁵ The Mass Transit Account currently does not encounter the same difficulty only because a change in the way various transit programs are funded that was incorporated in SAFETEA-LU has helped slow down expenditures from the Account. Nevertheless, the cash balances in the Mass Transit Account are projected to run out in 2013.

to be the primary method of funding our highway and transit programs in the future. The purpose of this hearing is to develop a better understanding of this financing mechanism and its structure.

PREVIOUS SUBCOMMITTEE ACTION

The Subcommittee held an oversight hearing in April 2006 on the reliability of the revenue estimate for the HTF.

WITNESS LIST

Mr. Donald B. Marron

Deputy Director
Congressional Budget Office
Washington, D.C.

Dr. William Buechner

Vice President for Economics and Research
American Road and Transportation Builders Association
Washington, D.C.

Daniel Sperling

Professor and Director
University of California- Davis
Institute of Transportation Studies
Davis, CA

Mr. Alan Pisarski

Private Consultant
Falls Church, Virginia