STATEMENT OF
THE HONORABLE POLLY TROTTENBERG
UNDER SECRETARY FOR POLICY
U.S. DEPARTMENT OF TRANSPORTATION

BEFORE THE

SUBCOMMITTEE ON HIGHWAYS AND TRANSIT
COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
U.S. HOUSE OF REPRESENTATIVES

How the Financial Status of the Highway Trust Fund Impacts Surface Transportation Programs

July 23, 2013

Chairman Petri, Ranking Member DeFazio, and Members of the Subcommittee:

Thank you for the opportunity to appear before you today on behalf of the Obama Administration and Secretary Anthony Foxx to discuss the future of the Highway Trust Fund (HTF or Trust Fund) and its role in supporting our Nation's transportation needs.

Since its inception, the HTF has provided a successful model for funding surface transportation investments. Yet in recent years, investment needs and authorized funding levels have outpaced the available highway-user revenues. As a result, for the past five years, the HTF has come perilously close to being insolvent. Although collectively the Administration and the Congress have successfully used a variety of short-term measures to keep the Trust Fund solvent, we need a more permanent solution.

<u>History</u>

As you know, the Trust Fund was established in 1956 to provide a financially sound, reliable, and consistent approach for funding highway infrastructure, and over time transit and highway safety programs. This funding construct benefited from two key elements. First, by using a "trust fund" mechanism, major decisions about the HTF were decided in multi-year authorization bills rather than through the annual appropriations process. This provided assurances to the States and other grant recipients that resources needed to finance their major projects would be available over a longer time horizon, giving State legislatures and transportation planners confidence to move forward with project development.

A second key element was the establishment of a dedicated funding source. The Trust Fund was created based on the "user pays" principle, in which highway users pay a cents per gallon fuel tax on gasoline and diesel (and eventually gasohol), in addition to other related excise taxes, with revenue dedicated to the HTF. Revenues from the motor fuel tax are deposited into the U.S. Treasury, and in turn are made available to the Trust Fund for expenditures by State highway and transit agencies. In 1956 the gasoline tax rate was 3 cents per gallon and in 1959 it was increased to 4 cents per gallon. In 1982, President Ronald Reagan signed the *Surface Transportation Assistance Act* which raised the gas tax to 9 cents per gallon and expanded the use of the HTF to include a new account to support public transportation. It was at this point that the HTF was divided into the Highway Account and the Mass Transit Account. In 1990, President George H.W. Bush signed the *Omnibus Budget Reconciliation Act* which raised the gas tax by 5 cents, bringing it to 14.1 cents per gallon but with half of the increase going into the General Fund for federal deficit reduction. In 1993, President Bill Clinton signed a bill increasing the tax by 4.3 cents, bringing the total to 18.4 cents per gallon, with the entire increase going into the general Fund for deficit reduction.

Eventually the portions of the gasoline tax reserved for deficit reduction were redirected to the HTF. The initial 2.5 cents for deficit reduction was redirected beginning in October 1995 per the *Omnibus Budget Reconciliation Act of 1993*. The remaining 4.3 cents for deficit reduction were redirected to the HTF per the *Taxpayer Relief Act* of 1997. Of the 18.3 cents dedicated to the HTF, 15.44 cents goes to the Highway Account and 2.86 cents to the Mass Transit Account.

For the first four decades of its existence, the HTF collected interest on unspent balances. The *Transportation Equity Act for the 21st Century* (TEA-21) eliminated that authority effective September 1998. Congress later restored the HTF's ability to earn interest in the Surface Transportation Extension Act of 2010.

Although purchasing power has decreased and construction costs have increased by more than 70 percent over the last two decades, the 18.4 cent gas tax has not been changed since 1993.

<u>Recent Solvency Concerns</u>

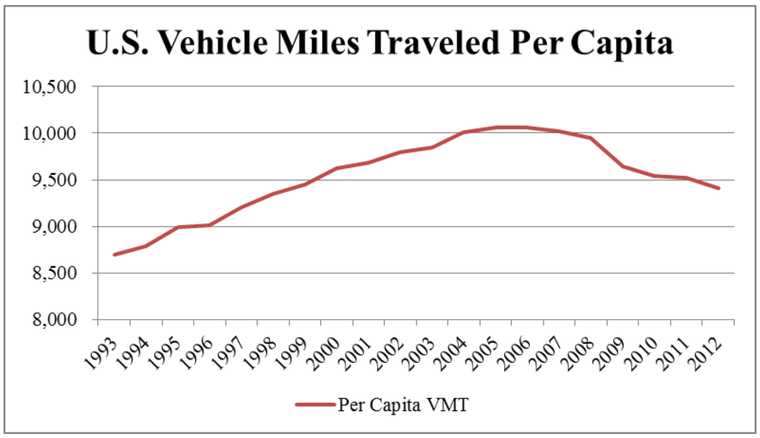
Until 2007, the HTF was generally viewed as an effective model for financing our national surface transportation investments. This mechanism provided funds for needed reinvestment in existing surface transportation infrastructure as well as new construction and expansion. Prior to this time period, the balances in the Highway Account exceeded the projected spending needs by several billion dollars. However, longer-term projections were already showing a downward trend in the Highway Account.

In late Fiscal Year (FY) 2008, the Department of Transportation announced that there was insufficient cash in the Highway Account to fully cover all outstanding bills, with ‘bills’ primarily referring to reimbursement requests for work States and metropolitan planning organizations had already performed. This was the first the Highway Trust Fund faced a significant cash shortfall in nearly 50 years. The Federal Highway Administration (FHWA) immediately ceased its twice daily bill payments and began to make bill payments once a week. This enabled FHWA to better calculate how much funding was available to pay bills and determine a pro-rata share across the States should insufficient cash be available to pay all of the agency’s bills.

Transportation Secretary Mary Peters asked the Congress for additional funds to restore solvency to the Trust Fund, which was provided. The *Amend the Internal Revenue Code of 1986 to Restore the Highway Trust Fund Act* transferred $8.017 billion from the General Fund to the Highway Account of the HTF—an amount sufficient to maintain baseline program levels through the end of FY 2008. While this resolved the immediate shortfall in the Fund, it did not resolve the widening gap between HTF receipts and baseline surface transportation spending. To keep the Fund solvent, through several Acts Congress has cumulatively transferred $54.5 billion in general funds to augment the Trust Fund.

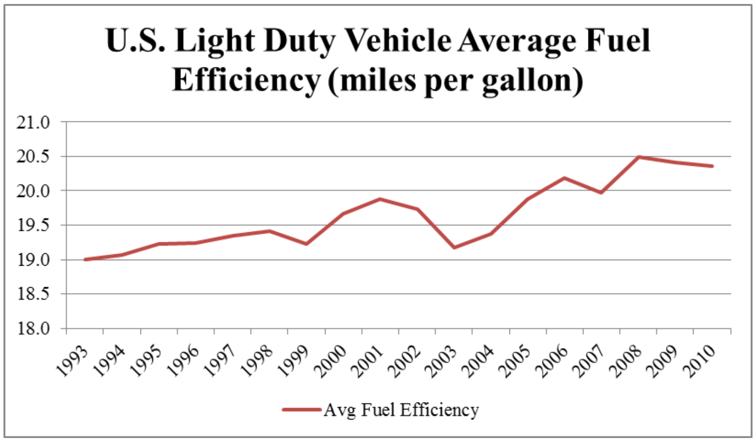
Short and Long Term Factors

A number of converging factors have brought the Trust Fund to its current state: a structural deficit that is not projected to subside. Beginning with sharp increases in fuel prices last decade, the rate of growth of vehicle miles traveled (VMT) declined as Americans began to economize their fuel consumption. This trend was exacerbated by the "Great Recession" in late 2007. Per capita VMT peaked in 2005 and continues to fall. Annual VMT dropped from approximately 3.03 trillion in 2008 to approximately 2.95 trillion as of April 2013.



It is generally recognized that the decline in VMT, and the corresponding decrease in fuel tax revenue between 2007 and 2009, was partially a reflection of fewer people and goods moving on our Nation's highways as economic activity slowed. However, evidence suggests that the flattening or decline of VMT is a long-term trend independent of the recession, as VMT has generally continued to decline annually since 2009 when the economy began to recover.

Two fundamental shifts have occurred that are projected to continue this trend for the foreseeable future. The first is the increased popularity of more fuel efficient vehicles. From the perspective of drivers, fuel efficient vehicles offer a way to reduce costs while also reducing environmental impacts. As proud as we are of our accomplishments on Corporate Average Fuel Economy or CAFE, paradoxically, improvements in fuel efficiency contribute to a reduction in the Trust Fund's resources and our ability to continue improvement of the Nation's transportation system. In 1993, the average gas mileage of a light duty vehicle was 19 miles per gallon; two decades later it has improved by more than 10 percent.



A second fundamental factor is a generational shift in travel preferences in the Millennial Generation and among retiring Baby Boomers. Increasingly these cohorts are moving into mixed-use urban cores where the need for driving is reduced. The 2010 Census saw for the first time more than 80 percent of the population living in urbanized areas. Study after study has shown this market trend to be real and continuing to impact real estate demand. Some choose to get rid of their car for economic reasons, some for social reasons, and some decide to never get a car in the first place.

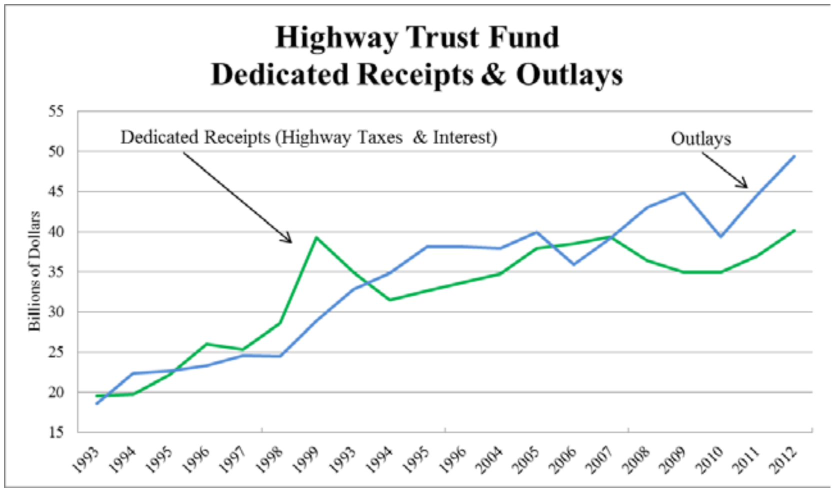
This has also resulted in an increasing demand for alternative forms of transportation, including transit, rail, walking and biking, which has larger policy implications for future transportation planning and investment.

Despite the recent decrease in revenue, authorized surface transportation spending increased, and has continued to increase. Labor and material costs associated with highway construction have generally increased. While some of the increased spending reflects investment in additional projects, we must also recognize that each year that goes by every dollar purchases a little less. A highway built in 2013 simply costs more to plan and construct than a similar one built in 1993. It is not surprising that the contrast between our spending needs and a decline in HTF resources has brought us to this point, even though annual spending has been consistent with baseline estimates.

Current Projections

The President's FY 2014 Mid-Session Review estimates that the Highway Account of the Highway Trust Fund will have a cash balance of $4.6 billion while the Mass Transit Account will have a cash balance of $300 million by the end of FY 2014.

When all these combined factors are considered, our the current data indicates that both the Highway Account and the Mass Transit Account of the Highway Trust Fund will face another shortfall soon after the end of FY 2014. While the timing of the forecasts is subject to change, there is little doubt that another funding shortfall will soon be upon us. Based on our projections, over the next 6 years, there will be a persistent and growing gap.



It is also helpful to understand how funds are awarded and grantees are paid from the Highway and Mass Transit Accounts.

As prescribed by statute, FHWA annually apportions a majority of Federal-aid funding to States through six core formula programs. The funds are provided to each State within funding categories or programs that focus on key areas, such as the National Highway Performance Program, Surface Transportation Program, and Highway Safety Improvement Program. State DOTs are the designated recipients or “grantees” for the funds and oversee decisions regarding the selection of projects for funding and are responsible for ensuring Federal requirements are met, including those for funds eligibility.

Cash is not provided in advance. Based on the notice of funds distribution, a State DOT enters into agreements with the FHWA to commit Federal funds to projects and then subsequently awards contracts to construction companies to do the work.

States rely on prompt payments from the Highway Trust Fund to pay their contractors. FHWA pays grantees the actual eligible expenses incurred on a progress payment basis as the State DOT submits bills to FHWA. Some States bill FHWA every day while others seek reimbursement weekly or semimonthly. The total amount of these payments out of the HTF fluctuates during the fiscal year and can exceed $5 billion in a given month.

Should the Highway Account of the HTF experience a cash shortfall, FHWA would implement established cash management procedures. The exact response would be dependent on the specific situation; however, FHWA may implement some or all of the following procedures depending on the scope and duration of the situation:

- Move from reimbursing State DOTs on a daily basis to a weekly basis.
- Provide partial, pro-rated reimbursements to State DOTs based on cash on hand.
- Align payment frequency with deposits into the Highway Account (twice monthly payments).

Should the shortfall situation continue, FHWA may ultimately make partial payments twice a month, based on the amount of cash deposited into the Highway Account. These deposits would only allow FHWA to cover a fraction of States' reimbursement requests. A reduction in the frequency and amount of reimbursements to State DOTs would have a negative impact on the States' ability to continue their level of infrastructure investment, including critical safety and state of good repair projects, and repayment of debt.

Briefly, the Federal Transit Administration (FTA) formula funds are apportioned each year to urbanized areas and rural areas based on statutory requirements like population and the level of transit service (vehicle revenue miles) reported to FTA. There are approximately 800 urban transit providers and more than 1,300 rural transit providers who receive or benefit from FTA funding.

Once funds are apportioned, transit grantees submit grant applications to FTA identifying projects that will be funded. FTA then approves the grants, which authorizes grantees to be reimbursed for eligible project expenses on a rolling basis. The amount of these payments fluctuates during the fiscal year and can be as high as $1 billion in a given month.

Given the estimated shortfall in the Mass Transit Account, FTA estimates that a $1 billion “cash cushion” must be maintained to ensure that it will have sufficient cash-on-hand at all times to pay grantees. If the balance in the Mass Transit Account falls below $1 billion, FTA will have to implement cash management procedures and – at that point in time when there is insufficient cash to pay its bills – will slow down payments to grantees to stretch out the available cash-on-hand.

The continued long-term solvency of the HTF impacts all FTA grantees, especially those is smaller and rural communities. A large number of FTA’s 1,300 rural transit providers would be profoundly impacted by a sudden shortfall in funding due to the significant federal contribution involved in these projects. For example, Grand Gateway Economic Development Association serving Big Cabin, Oklahoma relied on more than $2.5 million from FTA in 2012 alone, which was 59.8 percent of the transit agency’s annual budget. And in South Carolina, Waccamaw Regional Transportation Authority received more than $3.3 million in 2012 – nearly 53 percent of that agency’s annual budget. And, Flagstaff, Arizona’s Northern Arizona Intergovernmental Public Transportation Authority received just shy of 58 percent of its annual budget from FTA.

Looking Forward

The need for investment in our Nation’s surface transportation system is obvious to all of us. The 2010 Conditions and Performance Report, estimated that maintaining the Nation’s highway system, and improving it to meet future demand, would require that all levels of government combined increase capital investments from $91 billion currently spent to $170 billion annually over a 20-year period.

The same 2010 report estimates that achieving a state of good repair for the nation’s transit systems, while accommodating future ridership growth over a 20-year period, requires an annual increase in capital investments from $16 billion currently spent to between $21 billion and $25 billion. Both of these investment need estimates do not take into account operations and maintenance costs, and are based on 2008 data. The Department is currently preparing a new Conditions and Performance report which will contain updated investment need figures.

The Administration has consistently proposed groundbreaking commitments to not only expand transit options for Americans, but just as importantly, maintain our transit systems in a state of good repair. A September 2010 FTA study found that the nation's transit systems, including bus systems, have a $78 billion backlog of assets in marginal or poor condition and that our nation's transit systems will require an estimated $14.4 billion annual investment to continue to maintain a state of good repair once that backlog is addressed.

In his fiscal year 2014 budget proposal, President Obama proposed a bold $50 billion "Fix-it-First" initiative to spur economic investment and to rebuild America's transportation network. The President proposed $9 billion in upfront investments for critical transit infrastructure investments, including $6 billion specifically to address transit state of good repair needs.

The state of good repair of our public transit network is a matter of safety, efficiency, and reliability. If we do not make the tough decisions now, we will be compromising the safety of our riders and the strength of our economy as the movement of people and goods slows.

Looking forward, we have an opportunity to arrive at a solution that will ensure that the Trust Fund has the capacity to meet these long-term investment needs.

Administration Proposed Funding Solutions

Improving our highway and transit infrastructure provides jobs, benefits our citizens, our businesses, our economy, and our way of life. Finding a solution that acknowledges all of these factors should be our collective goal.

Ultimately, we need to keep in mind that any additional resources provided to the Trust Fund – either from Trust Fund taxes or from General Fund taxes – are paid for by the American people. Therefore, it is critical that we maximize the efficiency of our current investments. This will ensure we are getting the most bang for our buck and will demonstrate good stewardship of scarce public funds. And we must be vigilant about not only pursuing cost savings in project delivery and program management, but also through enhancing the capacity and throughput of existing transportation facilities through better use of innovation, technology and operational improvements.

Over the past five years, a variety of solutions have been offered to help keep the Trust Fund solvent, but none have yet been universally embraced as a long-term solution. The Obama Administration looks forward to working with Congress and transportation stakeholders throughout the country to find a bipartisan solution to this urgent challenge.

Thank you. I am happy to answer any questions you may have.