COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Trust or Bust: Fixing the Highway Trust Fund
June 18, 2014

Congress is facing two upcoming deadlines regarding surface transportation programs. At the end of September, the current authorization for highway programs expires and must be renewed. More immediately this summer, the Highway Trust Fund (HTF) will have insufficient funds to continue operating. Failing to replenish this trust fund will cause serious disruption and bring many transportation projects to a stand-still. On the other hand, allowing the HTF to continue to spend beyond dedicated revenue could worsen an already dismal federal debt situation. Fortunately, there are responsible ways forward.

Highway spending has exceeded gas tax and other dedicated revenues regularly over the past decade, and this shortfall will only grow over time. Dedicated revenues currently fund less than three-quarters of total HTF spending, a concern that lawmakers have addressed in recent years by transferring $54 billion of mostly general tax revenue into the HTF (only $18 billion was paid for and partially with a gimmick). In FY2015 alone, highway spending could exceed revenues by nearly $15 billion, and ***over the next decade that gap will approach $170 billion***.

There is broad bipartisan support for funding highways and other transportation infrastructure, which can both help to create jobs in the near-term and enhance long-term economic growth by fostering commerce, communication, tourism, and trade. Unfortunately, policymakers have so far been unable to agree on how to *pay for* desired levels of highway spending. In the coming months, ***Congress and the President must identify and agree to a fiscally responsible solution to close the HTF shortfall.***

The best approach to address the shortfall would be a long-term highway bill that aligns dedicated revenues with transportation spending. Transferring funds from general revenue into the HTF would be an acceptable alternative if and only if those funds were fully offset with real spending cuts and/or tax increases elsewhere in the budget. ***Under no circumstance should lawmakers rely on a deficit-financed (or gimmick-financed) general revenue transfer to fund the HTF.***

In addition to addressing the funding shortfall facing our highways, policymakers should use the highway bill to ensure better prioritization of funding projects and, importantly, to reform the budgetary treatment of highway spending. The HTF has a unique treatment in the budget, making it immune to the normal forms of budget discipline that ensure policymakers account for the full costs of legislation they pass.

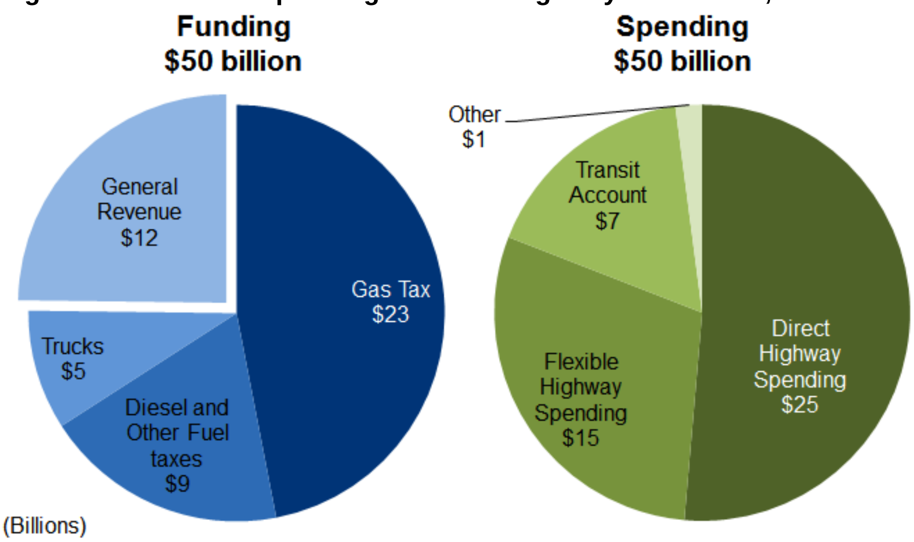
Federal Highway Spending and Revenue

The Highway Trust Fund (HTF) was established in 1956 to help finance the interstate highway system. With over $50 billion spent from the HTF each year, the federal government currently provides more than one-quarter of total highway funding, with the remaining funds paid primarily by state and local governments.

Most spending from the HTF goes to highway programs. In FY2013, about 80 percent of the $50 billion of contract authority went to spending on the National Highway System, grants to states for surface transportation improvements, highway safety programs, and programs designed specifically for U.S. territories and Puerto Rico. The remaining funds are for mass transit spending, mostly taking the form of grants to states and localities to improve rail, bus, and other transportation systems.

Revenue to finance this spending comes from a variety of sources. In 2013, 47 percent of revenues came from an 18.4 cent per gallon gasoline tax, 19 percent from a 24.4 cent per gallon tax on diesel and other fuels[1], and 9 percent from various taxes and fees targeted towards heavy vehicles. The remaining 25 percent effectively came from general revenue transfers, meaning dedicated revenue sources cover only three-quarters of HTF spending.

Fig. 1. Revenue and Spending From the Highway Trust Fund, 2013



Source: Congressional Budget Office, U.S. Department of Transportation

The Highway Trust Fund Shortfall

Between 2000 and 2014 spending from the HTF has grown about 60 percent while revenues have grown about 10 percent. Specifically, spending has grown from $33 billion in 2000 to $53 billion in 2014, while revenue has climbed from $35 billion to $38 billion. This discrepancy exists

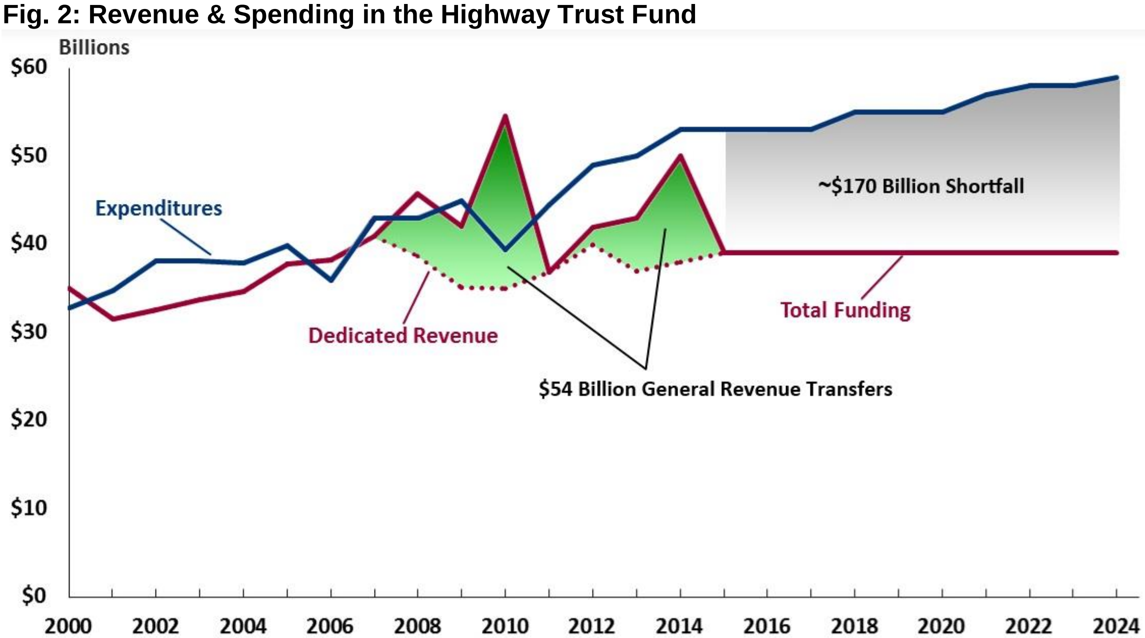
[1] Technically, 0.1 cent of the gas and diesel tax is contributed to the Leaky Underground Storage Tank fund, not the HTF.

largely because cars have become more fuel efficient and the gas tax has not kept pace with inflation (and in fact has not increased at all since 1993).

Highway spending has generally exceeded dedicated revenue since 2001, requiring a total of $54 billion of general revenue transfers since 2008, representing **one-sixth** of total spending. Unfortunately, only $15 billion of those transfers were accompanied with offsetting spending cuts or tax increases, and many of those offsets were "gimmicks" rather than actual savings. For example, half the transfer in the last highway bill was paid for with "pension smoothing," a change which shifts revenue forward several years but does not change total taxes paid.

These band-aid approaches have left a large structural gap between spending and revenue – nearly $15 billion this year – and that gap is projected to grow over time if spending grows while gas tax revenues remain roughly flat. If spending keeps pace with inflation, CBO projects the gap between spending and revenue will total about ***$170 billion*** over the next decade; proposals to increase highway spending beyond the rate of inflation would worsen the gap.

Fig. 2: Revenue & Spending in the Highway Trust Fund



Source: Congressional Budget Office, U.S. Department of Transportation

Policymakers will need to address this impending shortfall sooner rather than later. Although the current highway bill will not expire until September 30, the HTF will fall below the $5 billion threshold needed for smooth operation of the HTF sometime this summer.

Already, states face increasing uncertainty regarding federal funding of state projects**.** If Congress does not act to increase HTF balances by the end of July, the HTF will not have enough to reimburse states for projects under the current highway bill, forcing an immediate slowdown in highway construction this summer, which could cause project delays, layoffs, and larger economic harm. If this persists, all revenue coming in would be spent to meet existing obligations, leaving no room for new obligations in FY 2015.

The Right and Wrong Ways to Strengthen the Highway Trust Fund

Whether policymakers reauthorize the highway bill for one month or for ten years, they will need to address the large imbalances between spending and revenue in the HTF. The most responsible way to do so is by identifying long-term solutions that eliminate the structural gap between spending and dedicated revenue. An acceptable alternative, particularly as a "bridge" to cover shortfalls until structural reforms produce enough savings to close the shortfall or provide more time for further action on structural reforms, would be to transfer funds from general revenue while *fully paying* for that transfer through other tax or spending changes. Funding highway spending with deficit-financed or gimmick-financed general revenue transfers would be an irresponsible and unacceptable approach.

Fig. 3: Grading Approaches to Addressing Highway Funding Shortfalls

A	• Permanently bring highway spending and dedicated revenues in line
B	• Bring highway spending and dedicated revenues in line for several years
C/I	• Use a fully paid-for general revenue transfer to fund highway spending
F	• Use a deficit-financed general revenue transfer to fund highway spending • Use budget gimmicks to offsets transfers to fund highway spending.

The Best Option: Address the Structural Imbalance

The most fiscally responsible solution to the HTF shortfall would be to address the long-term structural imbalance by bringing dedicated revenues in line with spending. While lawmakers would still periodically reauthorize and revise spending allocations, making the HTF solvent would remove the need to constantly bail it out and eliminate the uncertainty created by periodic warnings of imminent HTF exhaustion.

Because Congress has relied on patchwork solutions in recent years and because gas tax revenue is projected to remain roughly flat, eliminating this structural imbalance will require bringing current revenues and spending in line (a gap of about $15 billion per year) while also addressing the future projected growth in spending levels (an additional $5 billion by 2024).

Fortunately, many of the options to close the gap are well-known and have been studied or discussed for a number of years. Options involve reducing federal spending on transportation infrastructure, increasing existing revenue sources, or identifying new funding sources. The options listed here only include transportation-related options, which maintain the general principle of "user pays" – highway revenues have historically come from highway users

On the spending side, bringing the HTF into balance over the next ten years would require a 35 percent spending cut, reducing new contract authority through 2024 from nearly $600 billion to below $400 billion. Short of this approach, policymakers could freeze highway spending over the next decade (which would close one-quarter of the ten-year gap), discontinue new projects for a period of time (a two-year hiatus would fully close the six-year gap and close two-thirds of the ten year gap), or eliminate certain types of transit spending.

On the revenue side, policymakers could fully close the ten-year gap by increasing the existing gas and diesel taxes by about 15 cents each or by immediately increasing them by 11 cents and then indexing both to inflation.[1] Solely indexing the current 18.4 and 24.4 cents per gallon taxes by inflation would close one-fifth of the ten-year funding gap, while raising the gas tax to the same level as the diesel tax would close one-third of the gap.

Finally, policymakers could rely on any of a large number of new funding sources from a vehicle registration fee to a surcharge on drivers' licenses, a tax on tires, or a fee on containers moving through U.S. ports, to name a few.

Box 1: Improving the Budgetary Treatment of Highway Spending

The unique budget treatment of the HTF allows it to evade budget rules meant to encourage budget discipline. The hybrid discretionary-mandatory treatment of highway spending, combined with the way future highway spending is projected, allows intergovernmental transfers into the HTF to be scored **without a cost**. Though this treatment might work in an isolated self-financed program, with highway spending increasingly funded by general revenue transfers; it should be subject to the same checks and balances as other federal spending.

Currently, budget rules limit new discretionary spending through statutory caps on *budget authority* and limit new mandatory spending by applying pay-as-you-go rules to mandatory *outlays*. However, highway spending evades both these limits since its *contract authority* counts as mandatory while its outlays count as discretionary. Meanwhile, current scorekeeping conventions assume that spending on highway programs will continue at current levels (adjusted for inflation) regardless of whether the HTF has sufficient funds to allow such spending. This convention implies that depositing more money in the HTF to allow spending above what current law allows *does not* increase spending relative to the CBO baseline.

The result is that *general revenue transfers into the HTF are not scored with a net cost to the government, even though they allow highway spending to be higher than what would otherwise be allowed.* This loophole allows policymakers to avoid finding offsets; it also lets them double count savings both to finance the HTF and offset other priorities. **The increased spending allowed by increasing trust fund balances should be scored as a cost requiring an offset to accurately reflect the impact of general revenue transfers and avoid double counting.** This goal could also be achieved by requiring all general revenue transfers to be offset and banning the use of dedicated highway funds for other purposes.[i]

More significantly, policymakers could classify both highway contract authority and outlays as mandatory spending and limit projected spending to the funds available in the HTF. Any increases in highway funding (including increased spending from legislation avoiding HTF depletion) would be subject to PAYGO rules which require all new spending (or tax cuts) to be fully paid for. This approach was recommended by the Fiscal Commission and is similar to what was included in the President's highway proposal.

Alternatively, both highway contract authority and outlays could be classified as discretionary spending, with discretionary spending caps adjusted upward to accommodate the reclassified HTF contract authority that can be supported by dedicated revenues.

[i] The House passed FY 2014 budget resolution established a scoring rule along these lines for purpose of House budget enforcement.

[1] The Joint Committee on Taxation assumes that about one-quarter of the increased revenue from excise taxes will be offset by declining income tax revenue. The increase in revenues described here are net estimates after accounting for lower income and payroll tax revenue. The result is that the HTF would be overfunded relative to the total revenue raised; those excess receipts could be credited to the general fund to repay previous transfers to the HTF or offset the reduction in income tax revenues.

Another option, suggested by the National Surface Transportation Policy and Revenue Study Commission, would be to move away from the gas tax altogether in favor of a vehicle miles traveled (VMT) fee that serves as a more direct "user fee" for road use. A tax of roughly 1.85 cents per mile would be enough to replace all existing transportation taxes and fully fund the HTF, however it would likely take a number of years and significant further study before any VMT could be sufficiently developed to be implemented.

Fig. 4: Options for Savings Within the Highway Trust Fund

Policy	Ten-Year Savings	Percent of Shortfall Closed		
		4-Year	6-Year	10-Year
Spending Options				
Freeze spending at 2014 levels	$40 billion	8%	14%	25%
Reduce spending to 2008 levels	$85 billion	45%	50%	50%
Reduce spending by 35%	$170 billion	75%	90%	100%
Eliminate new commitments for one year	$55 billion	70%	50%	30%
Eliminate new commitments for two years	$105 billion	140%	100%	60%
Eliminate funding for alternative transportation	$10 billion	5%	5%	5%
Repeal Davis-Bacon Act for highway projects	$5 billion	3%	4%	4%
Existing Revenue Options				
Index gas and diesel fuel taxes by inflation	$35 billion	9%	14%	20%
Raise gas and diesel fuel taxes by 15 cents	$170 billion	115%	110%	100%
Raise fuel taxes 11 cents and index to inflation	$170 billion	95%	100%	100%
Raise gas tax to match diesel tax	$55 billion	35%	35%	30%
Increase truck and trailer tax from 12% to 20%	$25 billion	15%	15%	15%
Repeal special rates on certain fuels	$20 billion	13%	12%	12%
Double heavy vehicle use tax	$10 billion	7%	7%	6%
Eliminate exemptions from the gas tax	$15 billion	10%	10%	9%
New Revenue Options				
Impose a $1 per barrel tax on oil	$50 billion	30%	30%	30%
Impose $10 per-tire tax	$25 billion	15%	15%	15%
Institute $20 fee on containers in U.S. ports	$10 billion	5%	5%	5%
Impose vehicle registration fee of $10 on light vehicles and $20 on trucks	$35 billion	20%	20%	20%
Institute $10 driver's license surcharge	$20 billion	12%	12%	12%
Impose 0.5 cent-per-mile VMT fee	$150 billion	90%	90%	90%
Replace current taxes w/ 1.85 cent-per-mile VMT fee	$170 billion	100%	100%	100%

Sources: CBO, National Surface Transportation Infrastructure Financing Commission, and CRFB calculations.
All numbers are rounded and calculated *very roughly* by CRFB based on data from a variety of sources. Percentages have been revised since initial publication to keep at least $6 billion in the HTF by the end of 2024.
Estimates are intended to include the effect of income and payroll tax offsets under the assumption that revenue losses are compensated with reverse revenue transfers.
Percentages represent average effect over the time period and do not address timing issues.

Even the most standard options, such as an increase in the gas tax, might not generate funds quickly enough to avoid temporary HTF exhaustion. For this reason, policymakers might combine a permanent solution with either temporary borrowing authority or a paid-for general revenue transfer that serves as a "bridge" to more structural reforms.

An Acceptable Option: Offset General Revenue Transfers

Although a structural fix is ultimately needed, Congress could extend the life of the HTF through a general revenue transfer. Technically, the transfer would be intragovernmental and therefore not add to the unified budget deficit. However, a transfer would enable spending to continue at levels above current law (which limits highway spending to dedicated revenues and existing balances in the HTF). ***Given this fact, any general revenue transfer into the HTF should be offset by real savings elsewhere in the budget.***

Although offsets can come from any part of the budget, there is a strong case for identifying savings from transportation-related spending or tax breaks, given the need to leave other savings "on the table" to address our mounting national debt.

On the tax side, policymakers could consider reducing or repealing any of a number of transportation-related tax breaks. Repealing the so-called "SUV loophole" – which allows businesses to deduct unlimited expenses for vehicles weighing more than 6,000 pounds – as most SUVs now do – would generate enough revenue to extend the HTF by about 8 months and close 5 percent of the ten-year gap. Closing various tax breaks for oil and gas companies could extend the fund for 2½ years and close 21 percent of the ten-year gap. Repealing the exclusion for new private activity bonds could extend the fund for 2 years and close 18 percent of the gap.

An alternative option, supported both by the White House and Chairman Camp, would be to deposit one-time transition revenue from business tax reform to the HTF – though it seems implausible that such reform could be enacted in time to address the immediate funding gap. It is critical that a general revenue transfer into the HTF reflect a net increase in revenues, and not double count revenues that are also used to offset other costs associated with tax reform.

Fig. 5: Options for Savings to Offset General Revenue Transfers

Policy	Ten-year Savings	Trust Fund Extension
Eliminate Amtrak subsidies*	$15 billion	12 months
Eliminate "Capital Investment Grants" to the rail system*	$15 billion	12 months
Allow oil drilling in ANWR and the Outer Continental Shell	$5 billion	4 months
Reduce Strategic Petroleum Reserve by 15 percent	$10 billion	8 months
Reduce federal research funding for fossil fuels and nuclear energy*	$5 billion	4 months
Eliminate tax exclusion for new Private Activity Bonds	$30 billion	24 months
Repeal certain oil and gas tax preferences^	$35 billion	30 months
Close Section 179 "luxury SUV" loophole	$10 billion	8 months
Dedicate temporary transition revenue from repealing LIFO to the HTF	$90 billion	6 years
Dedicate one-time "deemed repatriation" tax to the HTF	$125 billion	8 years
Repeal tax deduction for moving expenses	$10 billion	8 months
Deny biofuels credit for black liquor (retroactive)	$3 billion	3 months
Close the "gas guzzler" loophole	$1 billion	1 month

Sources: CBO and CRFB calculations.
All numbers are rounded and calculated *very roughly* by CRFB based on data from a variety of sources.
*These discretionary changes would need to be accompanied by reductions in the discretionary spending caps.
^includes expensing for exploration and development as well as the "percentage depletion allowance"

On the spending side, policymakers could consider eliminating certain federal transportation funding not financed by the HTF. For example, eliminating subsidies to AMTRAK (and reducing discretionary caps by an equivalent amount) would generate enough savings to extend the HTF by 1 year and close 9 percent of the ten-year gap. Eliminating federal research funding for fossil fuels and nuclear power would provide enough revenue to extend the HTF for 4 months.

Policymakers could also generate savings by expanding oil drilling or reducing the size of the strategic petroleum reserve, among other options.

An Unacceptable Option: Deficit-Finance Highway Spending

Relying on a paid-for general revenue transfer would be fiscally responsible, but would be only a temporary solution and represent a failed opportunity to bring highway spending and revenues in line. Failing to pay for that transfer would represent an even bigger failure, by adding to the national debt.

Under current budget scoring rules (see box 1), a general revenue transfer to the HTF to prevent it from being depleted is not scored with a cost because the baseline assumes spending will continue after HTF exhaustion. Yet while the transfer itself does not increase spending and deficit levels above the CBO baseline, it does allow more money to be spent on transportation than current law otherwise allows. As a result, such an approach would not only leave the HTF's finances out of balance but also further increase the record-high and rising national debt.

Using budget gimmicks such as a repatriation holiday or "pension smoothing" to generate revenue upfront but reduce it later, as lawmakers did in the previous highway authorization bill, could potentially be even worse than a clean general revenue transfer. These gimmicks would make a general revenue transfer appear to be fully offset with other savings when in reality they would exacerbate the country's long-term fiscal woes.

Conclusion

The HTF faces serious funding shortfalls over the next ten years – shortfalls that could have notable impacts on highway projects as soon as this summer. Adopting a fiscal responsible reform plan for the HTF is an opportunity to put those programs on a financially sustainable footing to ensure viable funding streams for future transportation projects.

Appendix: Existing Highway Trust Fund Proposals

A number of proposals have been put forward to reauthorize highway programs and/or provide funding for continued highway spending, though most would fall short of what is necessary to bring HTF spending in line with dedicated revenue over the long term.

Fig. 6: Proposals to Address the Highway Trust Fund Shortfall

	House GOP	Senate Dems	White House/DoT	Senate E&PW	Camp Tax Reform	Senator Murphy
Extension Period	<1 Year	<1 Year	4 Years	6 Years	7 Year	10 Year
Shortfall to Close	<$15 billion	<$15 billion	$62 billion	$95 billion	$112 billion	$170 billion
Spending Above Current Levels	n/a	$0 billion	$88 billion	$0 billion	n/a	Unknown
Source of Funding	Postal Reform	Repatriation Holiday	Tax Reform	n/a	Tax Reform	Gas Tax
Additional Funding	$12 billion	$0/$3/$30 billion*	$150 billion	n/a	$0/$127 billion^	~$130 billion

*This proposal will raise $30 billion over two years and $3 billion over ten, and it may **lose** revenue over the long-run.
^Although this proposal generates $127 billion, it uses that money to finance rate reduction and thus provides no net new resources.

Two very short-term solutions have been floated by leadership in both chambers**.** The ***House Republican leadership*** would transfer $12 billion into the HTF and pay for this mostly by ending certain Saturday mail delivery. While this proposal would likely extend the life of the HTF through May 2015, it would double count the offset – which would be used both to strengthen the HTF and to shore up the finances of the postal service. Recent press suggests House leadership may abandon this plan in favor of a gimmick known as pension smoothing – which would raise short-term revenue but significantly reduce it over the long-term.

The ***Senate Democratic Leadership*** plan, which appears to be supported by a number of Senate Republicans, would use revenue from the effects of a repatriation holiday to pay for a general revenue transfer. In combination with limiting the interest deductibility, this option reportedly generates about $30 billion over two years as companies repatriate funds, but only about $3 billion over the full decade – since the revenue largely represents a timing shift. Transferring the full $30 billion into the HTW would represent a major timing gimmick; transferring the $3 billion might represent a gimmick as well if further revenue losses are expected beyond 2024.

The ***Department of Transportation (DoT)*** (and the Obama Administration) has proposed a more medium-term solution, which would extend, reform, and significantly increase highway spending for the next four years. Specifically, the DOT proposal would increase spending by nearly $90 billion compared to current levels and offset this new spending – plus the $56 billion shortfall over that time period – with a general revenue transfer funded by temporary "transition" revenue gains from business tax reform. Although this funding source might make sense for one-time infrastructure spending increases in the legislation, funding such a large amount of *permanent* spending with *temporary* revenue sources would leave future policymakers with a large structural gap to close after that revenue is depleted. To the extent higher spending proves difficult to reverse, the proposal could *worsen* the structural gap.

The Senate Environment and Public Works (E&PW) Committee recently agreed to a plan that would reform and extend MAP-21 (the latest highway bill) for six years. Although the Senate bill makes several changes to transportation financing, it holds total spending to current levels (adjusted for inflation). In part because the Committee does not have jurisdiction over revenue, it includes no mechanism to fund the $90 billion six-year shortfall in the HTF. This gap must be closed before the Senate votes on the legislation.

In his recent tax reform legislation, *House Ways & Means Chairman Dave Camp* (R-MI) put forward a seven-year solution to the HTF shortfall. Although his legislation would not address highway authorization itself, it would deposit $127 billion of temporary transition revenue from "deemed repatriation" into the HTF, extending the fund's life through at least 2021. Not only does this proposal fail to close the HTF's structural gap, but unfortunately, it does not even generate real resources to fund highway spending. Instead, the legislation double counts the new revenue by using it to pay for lower tax rates and strengthening the HTF. This double counting is a gimmick that exploits the loophole created by budget scoring rules (see box 1 and CRFB's blog on this topic for more detail).

Unfortunately, none of the major highway proposals to date would make the HTF structurally sound over the long term. A plan floated from *Senator Chris Murphy* (D-CT) to increase the gas tax by 12 cents to 30.4 cents (equivalent to 1993 inflation-adjusted levels) *would* represent a more structural solution (though might fall somewhat short), if that money were dedicated solely to the HTF. However, some reports suggest this proposal also double counts the new gas tax revenue both for strengthening the HTF and for financing the extension of certain expired tax breaks.

CRFB will continue to follow and provide analysis on future plans to strengthen the HTF at http://www.crfb.org/blog/.