Committee for a Responsible Federal Budget

The Road to Sustainable Highway Spending

May 13, 2015

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Introduction

The current legislation authorizing highway and mass transit spending is scheduled to expire at the end of May, and only a few months later the Highway Trust Fund will run out of reserves. Extending the life of the trust fund through the end of the year will require $11 billion, and extending it for a decade will require nearly $175 billion.

For over 50 years, federal highway spending had been financed with dedicated revenue, mainly from the gas tax. Since 2008, however, dedicated revenues have fallen short of spending, and policymakers have covered the difference with about $65 billion of general revenue transfers – often without truly paying for the cost. Those transfers are projected to run out before the end of the year, disrupting infrastructure spending across the county.

To maintain important infrastructure investments and avoid adding an additional $175 billion to the debt, Congress must identify responsible solutions to close the shortfall in the Highway Trust Fund. Fortunately, Congress has many options at its disposal to do so (see the appendix).

One solution that has recently gained popularity would rely on revenue generated from business tax reform to close some of the $175 billion gap. While this would be a sensible solution, tax reform will not pass before the current highway bill expires, and there is a risk it will not pass at all this year.

CRFB's plan, *The Road to Sustainable Highway Spending*, would encourage the passage of tax reform while also ensuring the Highway Trust Fund remains adequately funded regardless of tax reform's fate. The plan would:

1. **Get the Trust Fund Up to Speed ($25 billion)** by paying the "legacy costs" of pre-2015 obligations with savings elsewhere in the budget.
2. **Bridge the Financing Gap ($150 billion)** with a default policy to raise the gas tax by 9 cents after a year and limit annual spending to income.
3. **Create a Fast Lane to Tax Reform** to help Congress identify alternative financing before the gas tax increase and spending limits take effect.

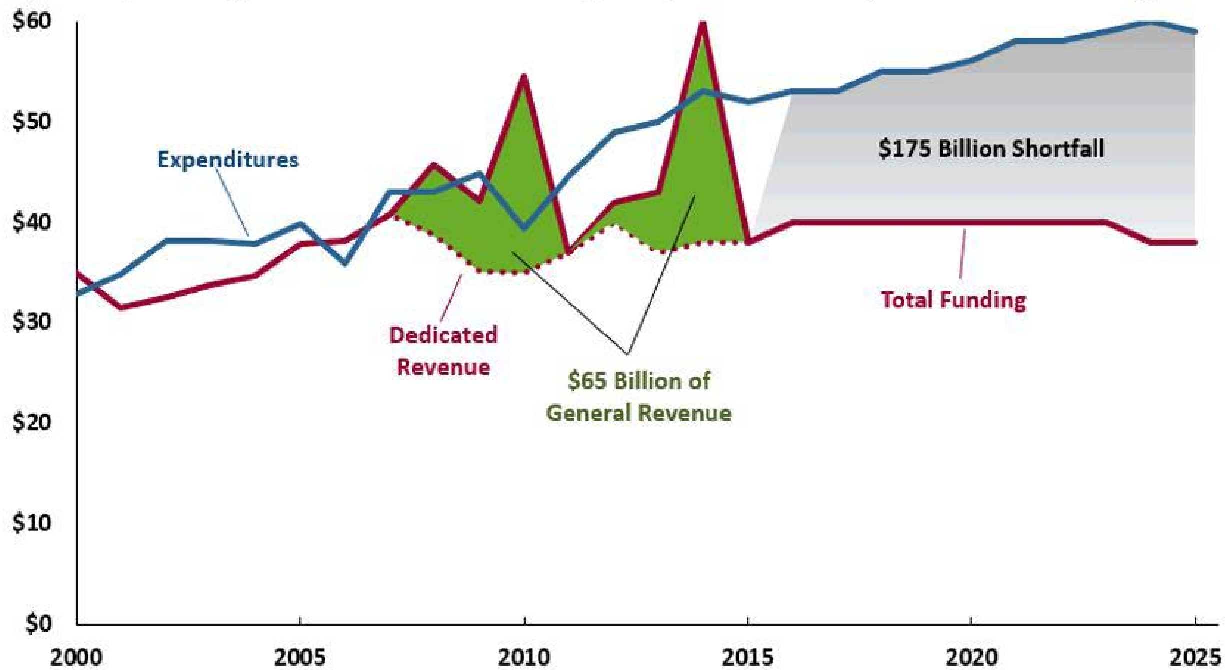
The Road to Sustainable Highway Spending would ensure the Highway Trust Fund remains solvent while giving policymakers flexibility to decide the level of highway spending and how it would be paid for. Our plan represents just one of many possible solutions. Importantly, any solution must responsibly address the gap between spending and revenue without resorting to gimmicks or deficit-financed transfers.

Background

Since 1956, most federal transportation infrastructure has been paid for out of the Highway Trust Fund.[1] Transportation is financed from an 18.4 cent per gallon gasoline tax, 24.4 cent diesel tax, and several smaller revenue sources. Since 2008, highway spending has continuously exceeded dedicated revenue. Nominal outlays have continued to rise modestly faster than inflation, while revenue deficit since 2008, the funds from these transfers are projected to run low by this summer, disrupting reimbursements for existing projects and putting new projects on hold.

Policymakers must identify $11 billion to ensure adequate funding through the end of this year and ***roughly $175 billion to maintain highway spending at current levels over the next decade.***

Fig. 1: Spending and Revenue in the Highway Trust Fund (Billions of Dollars)



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

has remained largely flat due to fuel efficiency improvements and the lack of inflation adjustment for the gas and diesel taxes.

This year, for example, federal highway spending will total $52 billion while dedicated revenue will equal only $39 billion – leaving a $13 billion deficit. That annual shortfall will grow to $23 billion by 2025. While general revenue has helped cover this

This is the equivalent of a 14 cent gas and diesel tax increase,[2] a 37 percent spending reduction, or a three-year delay of new projects. Time for action is running short. We explain many of the issues surrounding the Highway Trust Fund in more detail in our 2014 report, "[Trust or Bust: Fixing the Highway Trust Fund.](#)"

1 The Highway Trust Fund has two separate accounts: one for highways and one for mass transit. Technically, they have separate but related and intertwined financing.

2 This paper often describes the federal taxes on gasoline and diesel fuel together as "the gas tax." It also describes the "net revenue" raised, subtracting potential payroll and income tax losses.

Existing Plans to Fund Highway Spending

Fortunately, lawmakers have plenty of options to deal with the trust fund shortfall. In Trust or Bust, we identified four different types of options: reductions in federal highway spending, increases in existing revenue sources, new revenue sources, and general tax increases or spending cuts to offset general revenue transfers.

Since that report, a number of policymakers and outside groups have proposed to increase or index for inflation the federal gas tax. A bipartisan proposal introduced in the House this April, for example, would index the gas tax to inflation and put in place automatic tax increases in 2017 and 2020 to close the shortfall if lawmakers do not otherwise act.

An alternative proposal that appears to have growing traction would use revenue from business tax reform to close some of the funding gap. Both President Obama and former House Ways and Means Committee Chairman Dave Camp (R-MI) suggested using a deemed repatriation tax to finance a general revenue transfer. Current House Ways and Means Committee Chairman Paul Ryan (R-WI) and Senate Finance Committee Chairman Orrin Hatch (R-UT) have also suggested tax reform as a vehicle for highway funding.

Within tax reform, there are alternatives to funding highway spending, including "deemed repatriation," the use of temporary revenues from changing cost-recovery schedules, or more permanent changes to dedicated revenue sources such as the gas tax. With the right design, such reform would allow for continued infrastructure investment while also promoting economic growth by creating a more competitive tax code.

However, tax reform is not far enough along to pass in Congress before the highway bill expires at the end of May, is highly unlikely to be enacted before additional highway funding needs arise this summer, and might not pass at all this year due to the political challenges associated with designing and enacting major tax reform legislation. Relying solely on tax reform to fund the Highway Trust Fund could put its finances at risk.

Principles for Reform

Although lawmakers have many options to address the Highway Trust Fund shortfall, any responsible solution should abide by three principles:

1. **Act quickly to ensure adequate funding**. Congress must extend the highway bill this month and provide sufficient funding to avoid disruptions this summer.

2. **Offset any general revenue transfers with real savings.** While at least a short-term general revenue transfer is likely, it would be irresponsible to enact a transfer without equal-sized spending cuts or revenue increases to offset the cost. Using gimmicks such as pension smoothing undermine the trust fund's credibility.

3. **Close the structural imbalance**. Lawmakers cannot rely on general revenue transfers in perpetuity and must ultimately bring highway spending and dedicated revenue in line. Plans should close this gap, and any that fail to do so should acknowledge that further action will need to be taken in the future.

The Road to Sustainable Highway Spending

The Road to Sustainable Highway Spending acknowledges interest in using tax reform as a vehicle to fund the highway program, and facilitates efforts to do so. But rather than relying on tax reform as the only strategy, the plan ensures the Highway Trust Fund remains permanently solvent regardless of tax reform's ultimate fate. It also gives future Congresses both the authority and responsibility to decide how much the federal government should spend on infrastructure and how it will pay for such costs.

The Road to Sustainable Highway Spending has three parts. First, it would enact a fully-offset general revenue transfer to pay off "legacy costs" from past obligations made in 2014 and earlier. Second, it would ensure highway spending and revenue remain in line by extending the current highway bill for two years, scheduling a 9-cent gas tax increase at the end of the first year, and limiting future highway spending to trust fund income. Finally, the plan would create a "fast lane" process for tax reform, allowing Congress to identify alternatives or supplements to the scheduled gas tax increase before it takes effect.

Fig. 2: Summary of *The Road to Sustainable Highway Spending*

Policy	2015-2025 Savings
Get the Trust Fund Up To Speed	**$25 billion**
Reduce and reform agricultural subsidies	*$15 billion*
Extend mandatory sequester and existing aviation security fees through 2025	*$10 billion*
Bridge the Financing Gap	**$150 billion**
Schedule a 9-cent gas tax increase after one year	*$100 billion*
Continue highway bill for two years at current levels, then limit future annual contract authority to prior-year revenue plus interest collection	*$50 billion*
Create a Fast Lane to Tax and Transportation Reform	**n/a**
Encourage tax reform to replace or supplement gas tax increase	*
Encourage future highway bills to make tax and spending decisions together	*
Total, New Highway Trust Fund Financing	**$175 billion**

*Decisions may change timing and level of revenue and spending, but should have little overall impact on trust fund shortfall since new revenue would either pay for higher spending, lower taxes, or both.
Source: CBO, CRFB calculations

Get the Trust Fund Up To Speed – $25 billion

The Highway Trust Fund has about $25 billion of "legacy costs" from underfunded spending authorized prior to this year that is scheduled to be spent in future years. Under the current funding mechanism, future gas taxes (and other dedicated sources) would be required not only to pay for recent and new infrastructure projects, but also the projects established by prior Congresses.

The Road to Sustainable Highway Spending would fund legacy costs out of general revenue in hopefully the final transfer to the Highway Trust Fund. The plan would offset this transfer over ten years with $15 billion from reducing and reforming agricultural subsidies and $10 billion from extending the mandatory sequester and mandatory designation of aviation security fees through 2025. Other offsets could also be used.

Bridge the Financing Gap – $150 billion

Enact a Two-Year Highway Bill at Current Levels. The current highway bill expires at the end of May. *The Road to Sustainable Highway Spending* would continue the bill for two additional years, keeping nominal spending at that level over this time period. Alternatively, a 2-year highway bill could adjust spending levels in various areas, keeping top-line number the same. Savings could be achieved by expanding the use of tolls, reducing spending in lower priority areas like hiking trails, reforming contracting rules, leveraging private and state funding to reduce direct federal costs, or other changes.

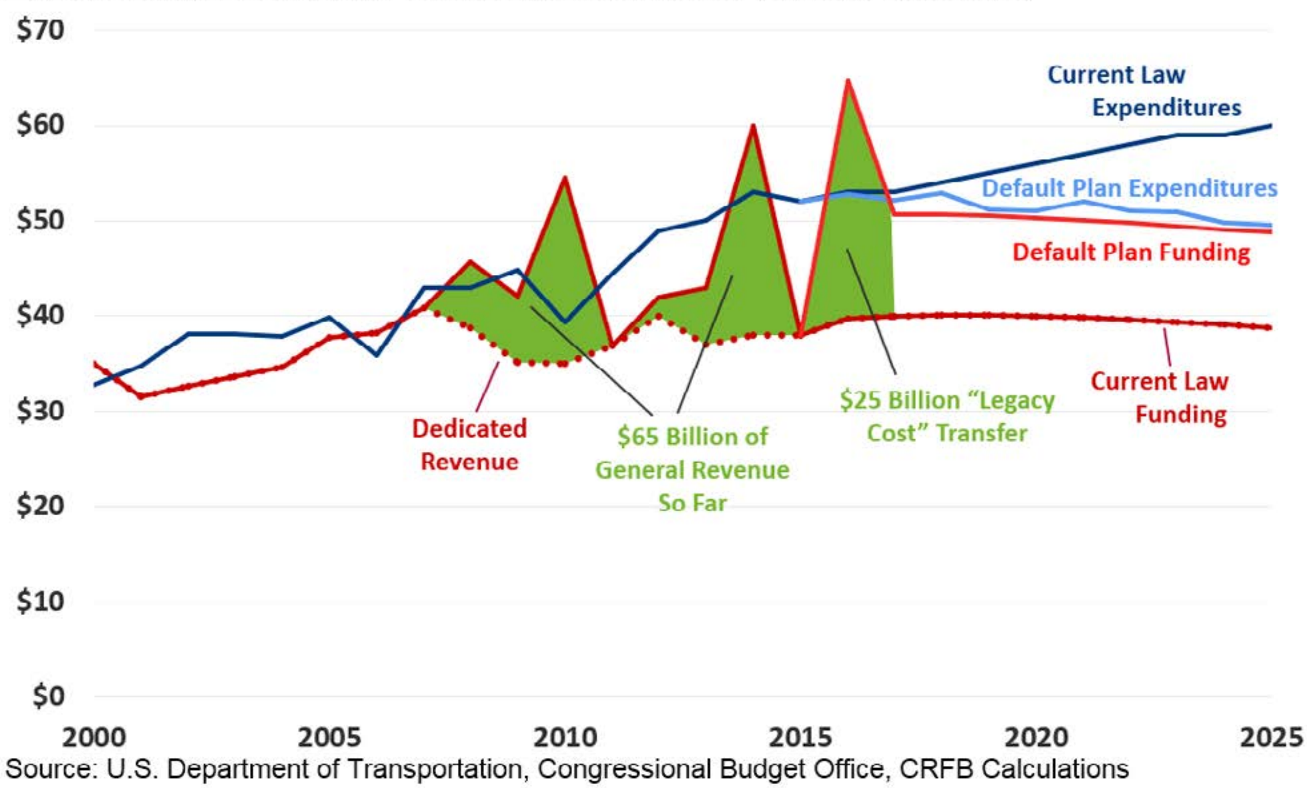
Schedule a 9-Cent Gas Tax Increase After One Year. Since 1993, the federal gas tax has totaled 18.4 cents per gallon (24.4 cents for diesel fuel) and has not been adjusted for inflation. Although *the Road to Sustainable Highway Spending* would give Congress the opportunity to identify a funding source of its choice, it would schedule a 9-cent gas tax increase by default – about adjusting the tax for past inflation – to take effect in June 2016. This would bring revenue up to current spending and raise $100 billion through 2025.[3]

Limit Future Highway Spending to Income. Although a 9-cent gas tax increase would bring revenue up to current spending, revenue would still fail to keep pace with inflation. To ensure future highway spending does not grow faster than gas tax revenue, *The Road to Sustainable Highway Spending* would limit future annual spending levels – as measured by contract authority – to revenue plus interest collection in the prior year. The plan would also change the budgetary treatment of highway spending so it is accounted for entirely on the mandatory side (for more details, see Box 1 of Trust or Bust). These two changes would prevent future trust fund shortfalls by requiring Congress to live within its means and would greatly reduce the likelihood of another general revenue transfer.

Technically, this change would hold spending to current revenue, roughly approximating a spending freeze that would require policymakers to either forego inflation adjustments or else cut lower priority spending. As a practical matter, it would require and empower future lawmakers to either increase revenue, reduce spending (relative to an inflation adjustment), identify alternative sources of financing, or some combination. In concert with the two-year freeze of highway spending described above, this policy would save about $50 billion over ten years.

3 Note that this policy would generate about $100 billion over ten years net of income and payroll tax losses. Actual revenue to the trust fund would be significantly higher. This excess revenue could be used to schedule "reverse general revenue transfers" to repay past un-offset transfers from general revenue.

Fig. 3: Spending and Revenue Under *The Road to Sustainable Highway Spending,* Assuming Default Tax and Spending Policies Remain in Effect (Billions of Dollars)



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

Create a Fast Lane to Tax and Transportation Reform

Encourage Tax Reform. Although *The Road to Sustainable Highway Spending* would schedule a future gas tax increase and constrain spending, it would give policymakers ample time and opportunity to identify an alternative revenue source to replace some or all of the gas tax increase and/or allow for increased spending up what whatever level of infrastructure investment policymakers believe appropriate. Specifically, the plan would create a special process for the passage of legislation that both reforms the tax code and provides funds for the Highway Trust Fund, so long as that plan doesn't double-count the highway money and otherwise abides by statutory pay-as-you-go (PAYGO) rules.

One option which appears to be gaining support would be to dedicate one-time revenue from tax reform – either from "deemed repatriation" or the temporary transition revenue from certain accounting or cost-recovery changes – to the Highway Trust Fund. Such a transfer could temporarily reduce or replace the scheduled gas tax increase, pay for increases in infrastructure spending, or both. ***Importantly, though, when the scheduled transfer ran out, the gas tax increase would go into effect without further legislation***.

A better alternative would be for tax reform to permanently increase dedicated revenue going toward the Highway Trust Fund – for example by reforming the gas tax[4] or creating a new source of revenue – in order to permanently replace the scheduled 9-cent gas tax increase and/or increase spending levels. Making such changes as part of a broader tax reform would make it easier for policymakers to address distributional concerns and provide transition relief if necessary.

Encourage Future Highway Bills to Make Tax and Spending Decisions Together. Currently, lawmakers determine highway funding in a disjointed and haphazard way by settling on spending levels and then providing ad hoc general revenue transfers. Instead, revenue and spending decisions should be made together. New highway bills should either set spending based on projected revenue levels or increase revenue levels to align with desired spending. By bringing revenue up to current spending levels and then setting strict caps to limit future spending to income, *The Road to Sustainable Highway Spending* would encourage such decision making. Further changes in the legislative process could reinforce this practice.

4 Among the options, the gas tax could be increased, indexed to inflation, replaced with a percentage tax, or replaced with a variable tax to add stability to the price of gasoline.

Conclusion

A lasting solution to the Highway Trust Fund's financing issue has evaded lawmakers for several years now, and the series of short-term patches often financed by gimmicks have not been helpful for transportation policy or the budget. However, recent developments such as lower gas prices and a number of proposals involving transition revenue from tax reform suggest that a bipartisan highway solution may be possible this year.

The Road to Sustainable Highway Spending combines a one-time general revenue transfer, a two-year highway bill, a future scheduled gas tax increase, and a requirement that highway spending remain at or below income in order to ensure the short- and long-term solvency of the Highway Trust Fund. At the same time, it creates a "fast lane" to tax and transportation reform to give Congress and the President the authority and responsibility to decide how highway spending will ultimately be paid for and at what level.

Importantly, this plan represents one of many different possibilities, as can be seen in the appendix, to solve the Highway Trust Fund's structural imbalance. Regardless of how it is done, it is important for lawmakers to come up with a real solution rather than continue to paper over the shortfall with budget gimmicks and deficit spending. A real solution will provide much more certainty for surface transportation projects across the country and improve the budget outlook.

Appendix

The policies contained in *The Road to Sustainable Highway Spending* are certainly not the only policies available to fund surface transportation spending. In this appendix, we provide several other options to close the Highway Trust Fund shortfall. Broadly speaking, we divide the options into four categories: reductions in federal highway spending, increases in existing revenue sources, new revenue sources, and general tax increases or spending cuts to offset general revenue transfers. As this appendix and the body of the report show, there is no shortage of options to make the Highway Trust Fund solvent.

Table 1: Options to Reduce Surface Transportation Spending

Policy	Ten-Year Savings	Percent of Shortfall Closed		
		4-Year	6-Year	10-Year
Freeze spending at 2015 levels for ten years	$45 billion	10%	15%	25%
Freeze spending at 2015 levels for two years	$15 billion	8%	8%	9%
Reduce spending to 2008 levels	$90 billion	50%	55%	55%
Reduce spending by 37 percent	$175 billion	95%	105%	100%
Limit spending to prior year's revenue	$155 billion	70%	80%	85%
Eliminate new commitments for one year	$50 billion	85%	60%	30%
Eliminate new commitments for two years	$105 billion	165%	115%	60%
Eliminate funding for capital investment grants	$15 billion	7%	9%	10%
Reduce Highway Safety Improvement funding to 2012 levels	$10 billion	6%	6%	7%
Reduce CMAQ program by 50%	$10 billion	5%	6%	6%
Eliminate funding for alternative transportation	$10 billion	5%	5%	5%
Return TIFIA program funding to 2012 levels	$10 billion	4%	4%	5%
Repeal Davis-Bacon Act for highway projects	$5 billion	3%	4%	4%
Eliminate funding for federal lands transportation	$5 billion	1%	2%	2%
Improve grants to focus on high-priority spending	N/A	N/A	N/A	N/A
Leverage state, local, and private spending	N/A	N/A	N/A	N/A

Sources: CBO, Federal Highway Administration, CRFB calculations
All numbers are rounded and calculated very roughly by CRFB based on data from a variety of sources.
Percentages represent average effect over the time period and do not address timing issues.

Table 2: Options to Increase Current Sources of Highway Revenues

Policy	Ten-Year Savings	Percent of Shortfall Closed		
		4-Year	6-Year	10-Year
Index gas and diesel fuel taxes to inflation	$40 billion	12%	17%	24%
Raise gas and diesel fuel taxes by 14 cents	$175 billion	134%	124%	100%
Raise fuel taxes by 11 cents and index to inflation	$175 billion	128%	120%	101%
Raise gas tax to match diesel tax	$55 billion	45%	40%	32%
Eliminate special exemptions from the gas tax	$15 billion	11%	10%	9%
Increase truck and trailer tax from 12% to 20%	$25 billion	17%	16%	13%
Double heavy vehicle use tax	$10 billion	7%	7%	6%
Double truck tire tax	$5 billion	4%	3%	2%
Repeal special tax rates on certain fuels	$20 billion	13%	12%	10%

Sources: CBO, National Surface Transportation Infrastructure Financing Commission, and CRFB calculations

Table 3: Options for New Sources of Revenue

Policy	Ten-Year Savings	Percent of Shortfall Closed		
		4-Year	6-Year	10-Year
Institute 1% motor fuel sales tax	$55 billion	40%	37%	32%
Impose $1 per barrel tax on oil	$45 billion	30%	30%	30%
Impose $10 per-tire tax on car tires	$30 billion	15%	15%	15%
Impose 2% vehicle sales tax	$15 billion	12%	11%	10%
Institute $20 fee on containers in U.S. ports	$10 billion	5%	5%	5%
Institute 0.05 cent per ton-mile tax on freight	$20 billion	12%	12%	12%
Apply 3.5% surcharge to customs duties	$10 billion	7%	7%	6%
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	85%	85%	85%
Replace current taxes w/1.9 cent-per-mile VMT fee	$175 billion	100%	100%	100%
Replace current taxes w/ carbon tax (rebate ~50%)	$175 billion	100%	100%	100%
Replace gas tax with a percentage tax	Dialable	N/A	N/A	N/A
Replace gas tax with flexible tax to help stabilize gas prices	Dialable	N/A	N/A	N/A

Sources: National Surface Transportation Infrastructure Financing Commission and CRFB calculations.
Numbers are rounded and calculated very roughly by CRFB.
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.

Table 4: Options to Offset a Transfer of General Revenue

Policy	Ten-Year Savings	Trust Fund Extension
Dedicate one-time "deemed repatriation" tax to the HTF	$125+ billion	8+ years
Dedicate temporary transition revenue from repealing LIFO to the HTF	$90 billion	6 years
Repeal certain oil and gas tax preferences^	$35 billion	30 months
Eliminate tax exclusion for new private activity bonds	$30 billion	24 months
Require filers to have a SSN to file for a refundable child tax credit	$20 billion	16 months
Eliminate Amtrak subsidies*	$15 billion	12 months
Eliminate "Capital Investment Grants" for the rail system*	$15 billion	12 months
Reduce farm subsidies	$15 billion	12 months
Close Section 179 "luxury SUV loophole"	$10 billion	8 months
Reduce Strategic Petroleum Reserve by 15 percent	$10 billion	8 months
Increase sequestration by $1 billion/year	$10 billion	8 months
Repeal tax deduction for moving expenses	$10 billion	8 months
Clarify worker classification	$10 billion	8 months
Prevent "double dipping" between unemployment & Social Security Disability	$5 billion	4 months
Allow drilling in ANWR and the Outer Continental Shelf	$5 billion	4 months
Reduce federal research funding for fossil fuels and nuclear energy*	$5 billion	4 months
Repeal or phase-out tax credit for plug-in electric vehicles	$1.5-$5 billion	1-4 months
Require inherited IRAs to be paid out within 5 years	$5 billion	4 months
Extend current Fannie/Freddie fees after 2021	$4 billion/year	3 months/year
Extend customs fees through 2025	$4 billion	3 months
Deny biofuels credit for black liquor (retroactively)	$3 billion	3 months
Increased mortgage reporting	$2 billion	~2 months
Require the IRS to hire private debt collectors	$2 billion	~2 months
Make coal excise tax permanent	$1.5 billion	~1 month
Clarification of statute of limitations on overstatement of basis	$1.5 billion	~1 month
Make Travel Promotion Surcharge permanent	$1 billion	~1 month
Close the "gas guzzler" loophole	$1 billion	~1 month
Enact federal oil and gas management reforms in the President's Budget	$1 billion	~1 month
Revoke passports for seriously delinquent taxpayers	<$0.5 billion	<1 month

Sources: CBO, OMB, JCT, and CRFB calculations
All numbers are rounded and calculated by CRFB based on 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.”