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Subcommittee on Surface Transportation

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The Highway Trust Fund

Mr. Chairman, Members of the Committee, I thank you for the opportunity to testify before you today on the current status and future outlook of the Highway Trust Fund and on the successful Federal-State efforts to address the very costly problem of fuel tax evasion. With me today is Jack Basso, Deputy Assistant Secretary for Budget and Programs.

Establishment of the Highway Trust Fund

The Highway Trust Fund was established by the Highway Revenue Act of 1956 (Revenue Act) in part to finance the increased authorizations Congress provided for the construction of the Interstate System. While Federal highway user taxes existed prior to that time, they were deposited in the general fund of the Treasury, and there was no tie between revenues collected and Federal funding for highways. Although a 40,000-mile National System of Interstate Highways was authorized to be designated in 1944, little progress had been made on the system until President Eisenhower signed the Federal-Aid Highway Act of 1956 (a part of the same legislation that established the Highway Trust Fund) into law, thereby increasing annual funding for this national system from $175 million in 1956 to $1.17 billion in fiscal year 1957, and rising to $2.2 billion in fiscal year 1960. To finance this massive public works project, the Revenue Act increased some of the existing highway user taxes, established new ones, and provided that the revenues from most of these taxes would be credited to a Highway Trust Fund.

From its inception, the Highway Trust Fund was not only the means of funding the construction of the Interstate System, but it supported other highway programs as well. In fact, by the mid 1970's, over one-half of the funds from the Highway Trust Fund went toward non-Interstate highway-related programs. In 1973, eligible trust fund uses were increased to permit States to use a portion of their highway funds on transit projects. The Surface Transportation Assistance Act of 1982 raised the fuel tax by 5 cents per gallon, from 4 cents to 9 cents--the first increase in 23 years--to fund an expanded highway and transit program. The 1982 Act also established the separate mass transit account within the Highway Trust Fund, dedicating to it 1 cent of the 9 cent Federal fuel tax. By this time, work on the Interstate System--the original impetus for establishing the trust fund--was 95.3 percent complete. Yet Congress recognized that increased Federal investment in surface transportation supported by dedicated user fees in the Highway Trust Fund continued to be important and necessary. After increases of 0.1 cents/gallon in 1987, 5 cents/gallon in 1990, and 4.3 cents/gallon in 1993, the Federal gasoline tax was reduced by 0.1 cents/gallon on January 1 of this year. Accordingly, the current Federal tax on gasoline totals 18.3 cents/gallon, with all but 4.3 cents/gallon of this total credited to the Highway Trust Fund.

<u>The Federal Role in Highway Transportation</u>

That critical need for a Federal role in transportation continues today as construction of the Interstate System draws to a close. The Highway Trust Fund is more than simply a vehicle for redistributing highway user tax revenues among States of varying size and population density or even a reliable means of operating a predominately user-financed transportation program. It is the means for funding programs by which the transportation concerns affecting the Nation as a whole are systematically and cohesively addressed in a way that would be impossible to replicate on the State level.

As we continue to define our views about what the next surface transportation legislation should include, we are principally examining the Federal role in meeting transportation needs. We look to build on the successes of the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA) as the foundation for future national surface transportation programs. The National Highway System, established under ISTEA, is one of our highest priorities since it is the backbone of our Nation's 21st century transportation system, serving to sustain the economic growth that has flourished during the Interstate era. President Clinton has stated that America's competitiveness in the world economy rests on the foundation of its infrastructure. Continued Federal leadership in transportation is needed to ensure that there is a cohesive, interconnected, intermodal network reaching across the Nation. Such leadership will require, among other things, continued Federal investment in our Nation's highway system. Ensuring the safety of the traveling public is a fundamental duty of the Department and one we take very seriously; any waning Federal commitment in this area could erode important safety gains. We also envision a Federal role in addressing the infrastructure needs of interstate and international commerce. In the area of motor carrier safety, we recognize that a single set of cohesive Federal standards has ensured that uniform safety rules are applied across the country. We believe that the Federal government continues to have a key role in ensuring sound transportation on Federal lands, protecting our environment, and in transportation research and technology to solve real-world problems, as we work to close the gap between what we are currently able to do and what we know is ultimately possible.

The Highway Trust Fund and Spending Levels

The Highway Trust Fund has been a reliable and stable source of funding for the improvement of highways over the past 40 years. The trust fund concept of dedicating motor vehicle fuel and truck taxes to transportation needs has enjoyed wide public support as a fair and prudent way to fund highway improvements. This steady and relatively predictable revenue source has given the Federal government and, in turn, State and local governments, the ability to plan for transportation needs in the future. This is a concept, along with contract authority for highway programs (which allows for the commitment of funds in advance of an appropriation), that has worked well and should be retained.

But trust fund spending must also be considered in the larger context of the bipartisan effort to balance the budget. The Administration is committed to balancing the budget, and all spending and taxing decisions should be made in this context.

Be assured that the current balance in the highway account of the trust fund, totaling $9.421 billion at the end of fiscal year 1995, is not surplus revenue languishing in the trust fund. At the end of fiscal year 1995, there were also $44.2 billion in unpaid authorizations still outstanding, including $30.9 billion in unpaid obligations on projects already started. These are commitments against this balance and future tax receipts. In addition, this balance is invested, earning interest at an average rate of 7.1 percent over the life of ISTEA. This interest, too, is not simply sitting idle, because over the life of the trust fund, expenditures from the fund have exceeded tax receipts deposited into the fund. So interest as well as tax revenue has been spent out of the highway account.

We recognize that highway, bridge, and other surface transportation needs are great, and will continue to seek the highest funding possible. We have been successful in securing substantial funds for transportation investment in these tight budget years. This has been accomplished in part through the innovative finance programs, active efforts to secure private sector financial participation in public projects, and greater flexibility in the use of funds by recipients. Average annual federal transportation infrastructure investment over the past three years has been over 10 percent higher than it was in fiscal year 1993. Our fiscal year 1997 budget continues this strong record: we propose $19.5 billion in new highway investment--$1.5 billion higher than the fiscal year 1993 level. Although Federal spending has increased in this period, we recognize that there is still a substantial gap between the costs of needed transportation improvements and the Federal government's ability to fully pay for them. Our primary concern in future budgets and in ISTEA reauthorization will be to responsibly maximize the overall level of transportation investment within the framework of a balanced Federal budget.

Future Revenue to Highway Trust Fund

Growing concern about the environment, air quality standards, and dependence on foreign oil has resulted in legislation designed to increase the use of alternative transportation fuels and to require more fuel efficient vehicles. The Clean Air Act Amendments include several programs governing the use of cleaner fuels and open up the fuel market to non-petroleum additives. The Energy Policy Act of 1992 requires that the Federal Government, alternative fuel providers, State and local governments, and certain private fleets buy alternative fuel vehicles in increasing percentages when purchasing new light-duty vehicles, with the goal of replacing 10 percent of transportation petroleum fuel with alternative fuels by the year 2000, and 30 percent by 2010. The impacts of these programs and certain fuel tax exemptions on the Highway Trust Fund have been felt: DOT estimates that the lower Federal tax rates on gasohol have resulted in $5.9 billion in forgone revenues since fiscal year 1983. But revenue forecasts for the near term predict only a modest further decrease in future trust fund revenues as a result of these alternative fuels standards for a number of reasons.

First, alternative fuels, including liquefied petroleum gas (propane), neat alcohol fuels (such as M85), compressed and liquefied natural gases, and hydrogen, account for only a tiny fraction of all motor fuels consumed. For example, they totaled only 0.1 percent of total U.S. on-road fuel use in 1992. Second, although some alternative fuels are taxed at rates lower than gasoline and diesel fuels rates, by far the most commonly used alternative fuel, liquefied propane, is taxed at the same rate as gasoline. Methanol fuels are taxed at rates lower than gasoline, but contain less energy than gasoline and therefore methanol-fueled vehicles have higher fuel consumption rates, effectively neutralizing their impact on trust fund revenues. Third, fleets of government-owned light-duty vehicles, which are the principal targets of the Energy Policy Act, comprise only 1 percent of all light-duty vehicles and are being replaced at very slow rates due to general budget constraints and the relatively higher costs of alternative fuel vehicles. Fourth, the purchase of alternative fuel vehicles by the general public, the greatest potential market, is still limited by vehicle costs and concerns about the availability of fueling sites.

When alternative fuel vehicles become a significant part of the U.S. auto fleet, the revenue impacts will depend on the particular fuels they use. As noted above, vehicles burning propane and methanol do not cause revenue losses to the trust fund. However, vehicles burning compressed natural gas or electricity would pay no fuel taxes to the trust fund under the current tax law. The Partnership for a New Generation of Vehicles, a joint initiative by the Federal government and the domestic auto industry, has set a goal to triple the efficiency of the standard automobile over the next several decades to help meet environmental, energy, and global climate change goals. A prototype vehicle is to be introduced in the next decade. This vehicle could include a much more efficient conventional engine, or it could introduce non-fossil fuel sources. Such developments could have a long term effect on trust fund revenues, but the scope of their impact is difficult to predict at this time.

Similarly, we have predicted modest increases in fuel economy in projecting the impact of fuel efficiency on future trust fund revenues. Passenger car fleet fuel efficiency has increased substantially in recent years, as both government standards and consumer demands dictate that automakers build more fuel efficient vehicles. For example, fleet fuel efficiency increased from 15 miles per gallon in 1980 to 21.5 miles per gallon in 1994, thereby reducing the rate of trust fund revenues per vehicle-mile of travel. While passenger car travel grew by 43 percent during this same period, fuel consumption by these vehicles rose less than one percent. During the 1980's, the growth in fuel tax receipts that would have been expected, based on the increase in travel, was flattened by improving fuel economy. These improvements have slowed in the 1990's. The least fuel-efficient vehicles from the pre-oil shock period have already been retired, so we are no longer seeing dramatic changes in fuel efficiency as old gas guzzlers are replaced with newer vehicles. Also, increasing numbers of American drivers are replacing their passenger cars with light-duty trucks and sport utility vehicles, which are less fuel efficient than the vehicles they replace.

For the longer term, however, we will be looking at alternative means of assessing user fees for drivers.

Combating Fuel Tax Evasion

This Committee has been very involved in preventing criminal activities which have jeopardized the revenues of the Highway Trust Fund. During the last few years this Committee has held three very useful hearings in order to assure that fuel tax evasion ends. We would like to briefly mention current efforts to stem fuel tax evasion. We are all mindful that fuel tax evasion schemes can continue to undermine Highway Trust Fund revenues.

We believe that the funding the Congress has provided to deal with fuel tax evasion has had tremendous payoffs. Congress authorized initial funding for the program in 1990, and ISTEA authorized $5 million annually in contract authority funds from the Highway Trust Fund through FY 1997. By 1995, FHWA had about $22 million invested in this program, about $12 million of that provided to State fuel tax enforcement agencies and most of the remainder provided to the Internal Revenue Service (IRS).

Under the auspices of the Joint Federal/State Motor Fuel Tax Compliance Project, known as the Joint Project, a program Steering Committee and nine regional motor fuel tax enforcement task forces have been organized to foster cooperation among State and Federal agencies, and with the petroleum industry, to improve motor fuel tax compliance. Currently all of the States and the District of Columbia are participating in the program and we commend everyone for their extensive efforts and cooperation.

Some of the current activities reported at the most recent Steering Committee meeting in

March 1996 include:

--formation of a "below the rack" blending task force to develop strategies to detect kerosene or waste petroleum derivatives added to motor fuels to avoid paying the required taxes,

--negotiation of cooperative agreements to provide IRS funds to the States to perform roadside inspections of diesel fuel used in highway vehicles,

--efforts to improve information sharing among the States to prevent unreported deliveries across State lines by encouraging adoption of uniform reporting forms, definitions, and taxpayer identification numbers, and

--indictment and prosecution of some of the largest tax evasion cases ever investigated, such as the recent New Jersey case alleging $140 million in evaded State and Federal taxes.

One of the fundamental legislative changes that has considerably reduced tax evasion was the concentration of motor fuel tax collection at the terminal rack, both for Federal motor fuel taxes (for gasoline beginning January 1, 1988, under the Tax Reform Act of 1986, and for diesel beginning January 1, 1994, under the Omnibus Budget Reconciliation Act of 1993) and similar action by many States as well. Fuel dying was also mandated as of January 1, 1994, requiring all untaxed diesel fuel to be dyed.

Since those changes, the FHWA and our partners in this effort have learned that taxing fuels at the terminal rack and dyeing nontaxable diesel fuel are the best methods for preventing fraud, assuring that honest retailer and wholesalers do not have to compete with those supplied with untaxed fuel, and securing revenue needed to support the Nation's transportation infrastructure. The effects of this effort on trust fund revenues have been impressive. The total amount of 1994 receipts available for the trust funds increased by $1.23 billion over 1993, adjusting for the rate increase. Taking into account increased refunds and credits, and attributing some of the increase to economic growth, the Treasury Department recently estimated that diesel fuel tax receipts, net refunds, were $600-$700 million higher in 1994 than in 1993 due to improved compliance alone.

What did the Highway Trust Fund gain from these efforts? It has realized additional fuel tax revenues far beyond our expectations. FHWA has accumulated information documenting over $1 billion of revenue enhancements annually from compliance initiatives. Let me briefly summarize some of the revenue gains:

--Some $240 million are assessed annually from motor fuel tax audits and reviews of taxpayer returns.

--In the past 3 years, over $170 million of tax loss has been uncovered and prosecuted annually in criminal cases (investigators from the DOT Office of Inspector General assisted State and Federal agencies in many of these cases).

--Some $800 million in additional State and Federal revenues are being collected every year from diesel fuel taxes, since the Federal change in point of collection and diesel fuel dyeing took effect.

These gains to the Highway Trust Fund and to State revenues (total of $1.2 billion) are set forth in the following table:

Revenue Enhancement Summary
(Annual Impact, $ Million)

Enforcement Strategy	States	Federal (IRS)	Total
Audits (Assessments)	$140	$100	$240
Criminal Investigation (Estimated tax loss)	50	120	170
Dyed Fuel\Point of Collection (Revenue increase)	150	650	800
Total	$340	$870	$1,210

The decisions of this Committee and the Congress in funding the evasion program have meant money well-spent. It must be emphasized, however, that the FHWA funds represent only a part of the resource commitment that made these results possible. Additional tens of millions of dollars in State as well as Federal resources, and industry expenditures to implement the fuel dyeing program, were committed to this effort. The single most important contribution of the FHWA funds was to bring the parties affected by fuel tax evasion together to work cooperatively on solutions. Information sharing and cooperation cost little but pay huge dividends. Again, we compliment everyone involved in the project for their cooperation.

Inasmuch as the IRS is testifying today I will not go into the Treasury Department's revenue projections that have been affected by the success of these compliance efforts except to say that they are impressive and substantial and in the billions of dollars.

Some may feel that the Joint Project compliance effort has been so successful that evasion problems are now resolved. Even though the gains are remarkable and undoubtedly make a huge dent in the problem, one thing we have learned from the project is that attempts to evade will not diminish. The large sums involved and the concentration of tax liability in a relatively small number of companies mean that phenomenal sums can be stolen. As quickly as old schemes are put to rest, new ones are hatched. I am sure that the IRS can cite some of the continuing areas of concern.

The unmistakable conclusion from our efforts to date is that funds invested in motor fuel tax compliance programs pay substantial dividends. Accordingly, aggressive support for compliance initiatives should be an element of every transportation agency's financial planning portfolio. As we begin developing proposals for reauthorization of the surface transportation program, these results should figure prominently in deliberations to assure a strong financial base to meet our country's sizable and critical transportation needs.

Highway Trust Fund Revenue Outlook

Motor vehicle fuel taxes are the lifeblood of our highway revenue programs, with taxes on gasoline and diesel fuels providing roughly 87 percent of estimated receipts flowing into the Highway Trust Fund in fiscal year 1996. From the standpoint of revenue productivity, fuel taxes have no equal. These taxes are relatively easy to administer and they provide a reasonable way to charge vehicles in rough proportion to highway use. Even though we think motor fuel taxes will remain a major source of highway finance in the foreseeable future, we also recognize that a number of factors, such as fuel tax evasion, alternative fuels, and more fuel efficient vehicles, could affect the revenue productivity of our current motor fuel tax structure.

Because of our continuing concern with the long-term future of highway financing programs at all levels of government, we have supported research in this area examining possible long-term alternatives to motor fuel taxes. For example, a 1995 National Cooperative Highway Research Program report concluded that motor fuel taxes will remain important components of State and Federal surface transportation revenues for at least the next three decades.

In examining new user fee options, we are seeking to identify user fees that more directly assess charges to users according to costs attributable to their use. Our cost allocation study is on schedule for completion by September of this year. We are already witnessing the greater use of direct charges based on user tolls, and we have been supporting the efforts that many States and localities are undertaking in this area. For instance, several State and local governments are examining the potential use of mileage taxes. There has been limited use of weight-distance fees, and some areas are considering congestion charges to improve demand management on congested urban facilities. Vehicle mileage taxes, taxes based on both vehicle weight and miles, and vehicle registration fees have also been suggested as possible future supplements to or replacements for Federal fuel taxes. All of these alternatives have important revenue implications, which we believe must be examined as part of the long-term revenue future for highway transportation. It is too early to responsibly predict the future path of these alternatives, such as determining which alternative fuels will be the ultimate winners in the marketplace. The only certainty is the need to adapt our fuel tax provisions in the future to account for these changes.

Mr. Chairman, this concludes my prepared remarks. Mr. Basso and I would be pleased to answer any questions you have.