December 15, 1981

TO: CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: SECRETARY DREW LEWIS
DEPARTMENT OF TRANSPORTATION

ISSUE: Increased User Charges to Finance Federal Highway and Transit Programs

SUMMARY

This proposal suggests increasing highway user charges, beginning in FY 1983, by an equivalent five cents per gallon to bring current highway user charges into line with the level of expenditures required to maintain the system in an adequate condition. Approximately $4 to $5 billion per year would be used for Federal-aid highways and $1 billion per year would be used for capital assistance to mass transit. The proposal provides for needed investment in the transportation capital plant to ensure economic growth and improved productivity. It will improve the budget balance by an average of $4 billion a year in the first two years.

BACKGROUND

The nation's highway and mass transit systems are essential links in the operation of the economy. Three quarters of all highway travel takes place on the Federal-aid highway system, and, in our large cities, mass transit systems provide over 18 million trips daily.

The Federal Government has had a major responsibility for financing highways and transit for many years. Federal funds generated from highway user charges help finance the Interstate System which connects principal metropolitan and industrial centers, and serves national defense requirements. User charges also provide funds for the Primary System, which includes major statewide Federal-aid highways, the Secondary System, which includes major rural highways and the Urban System which includes both transit and highway capital projects in urban areas. In addition, bridge, highway repair and rehabilitation and safety projects are eligible for these funds. The Federal mass transit program, which is funded from the general fund, includes a discretionary capital grant program, a formula grant program for urbanized areas that local officials may choose to use for public transportation capital or operating assistance projects, and a similar formula grant program for non-urbanized areas. Under the current highway and mass transit formula programs, decisions regarding the use of funds are made at the state and local level. Thus, to a large extent, these programs reflect the Administration commitment to Federalism.

Due to the magnitude of their role in all aspects of the nation's commerce, these systems will exert a significant negative impact on the economy if allowed to deteriorate and become inefficient. The entire economy relies upon the efficient movement of freight and people. Nevertheless, there is substantial evidence that our highway and transit infrastructures are deteriorating rapidly. Overall highway performance is declining, and approximately one in five Federal-aid system bridges is deficient. In urban areas, where over half of all highway travel occurs, congestion has become a costly feature of peak-period travel. Critical deficiencies in mass transit performance threaten to compound the congested highway conditions. Transit facilities and equipment in older, large cities have reached a state of severe deterioration. Total needs now far exceed what can realistically be expected from both the cities' own finances and currently planned Federal assistance. This trend must be reversed. If it is not, the transit systems will rapidly deteriorate to the point that massive capital investments will be required to rehabilitate the rail lines or to provide compensating additional highway capacity. The cost of intercity freeway and parking facilities will be much greater than these relatively minor expenditures to improve the mass transit infrastructure. Further, the resulting inefficiencies and increased costs, in both goods and people movement, will begin to erode private sector productivity gains and dampen the nation's economic recovery.

Over the next decade, increased user charges will be required simply to maintain serviceability of the existing Federal-aid highway system. Indeed, the capital expenditures needed to preserve, maintain and complete the Interstate System total about $80 billion. Requirements for other Federal-aid highways, the Primary, Secondary and Urban Systems, are expected to amount to more than $100 billion in the 1980's just to maintain present conditions. Urban rail and bus transit capital investment needs will total another $40 billion over the next ten years.

If present Federal highway user charge levels are continued, and state and local financing increases only modestly, much of this investment will not take place. A deferral of these investments for a few years will cause maintenance and investment to be even more expensive in the years ahead. For example, a deferral of simple highway resurfacing work for as little as two years could triple the ultimate cost of restoration.

To avoid such consequences Federal highway and transit funding must be put on a sound long-term course through an increase in highway user charges. Such a step is long overdue, for there has been no increase in these user charges in more than twenty years, despite a quadrupling of costs over that period.

It should be noted that refinancing of the Highway Trust Fund is a decision long scheduled to be taken up in 1982. In anticipation of this issue, the Congress has directed a number of studies by the Department of the Treasury and the Department of Transportation that are done or near completion. At issue in the next session of Congress will be both highway program levels and the allocation of charges to the various users.

DESCRIPTION OF DOT PROPOSAL

Amount and Timing of User Charge: Beginning in FY 1983, highway user charges would be increased by an equivalent five cents per gallon of motor fuel to yield additional annual revenues of $5 to $6 billion. The proposed increase is expressed in terms of equivalent cents per gallon, although a combination of fuel and excise user charges would be required to ensure equitable allocation of contributions among user groups.

Program Levels: The Administration's pending legislation includes annual authorizations through FY 1986 of about $9 to $10 billion for highways and $3 billion for transit. This proposal would add $4 to $5 billion per year for Federal-aid highways and $1 billion per year for transit capital (See Table 1).

Delivery of the Funds and Recipients: The new highway revenues would go into the Highway Trust Fund and a new transit program formula would be established for the $1 billion per year for transit. The amounts authorized for the highway program would be allocated and distributed under the existing Federal-aid highway program structure. This would be fully in accord with the Administration's Federalism policies. Because of the structure and operation of the delivery mechanisms to be used virtually all investment decisions would be made at the state and local level.

Transit funds would be distributed to current "designated recipients" under a formula which directs 85 percent of the money to large cities' capital projects. Eligible transit projects would include capital investments in buses, bus facilities, and rail modernization, rolling stock, facilities and equipment. To accomodate the desire for state and local discretion, in areas where the funds are not needed for transit they could be used for highway projects, following certification by appropriate state or local authorities that there are no significant mass transit capital needs. The formula would give wide ranging authority to local officials to select projects for investment.

DISCUSSION

Adoption of this proposal would lead to a series of benefits. First, it would deal with many of the current highway and transit funding problems identified earlier. Specifically, the $4 to $5 billion per year increase in highway investment would:

1. Complete the Interstate System by 1990, even at the slightly higher cost of the redefinitions being considered by Congress;

2. Provide for restoration of Interstate pavement and bridges;

3. Maintain the current performance on the Primary System;

4. Eliminate the most critical bridge deficiencies; and

5. Prevent further deterioration of the Secondary and Urban Systems.

The $1 billion per year for mass transit would:

1. Accelerate rail transit modernization improvements in large cities;

2. Accelerate rehabilitation and procurement of necessary rail rolling stock;

3. Reduce the average age of the bus fleet; and

4. Revitalize and replace bus maintenance facilities.

Second, even while those problems are being dealt with, the user charge increase would also have a positive fiscal effect on the Federal budget. Because of the slow pay-out characteristics of highway and transit capital projects, the budget deficits would be reduced by an average of $4 billion per year in FY 1983 and FY 1984.

Third, adoption of this proposal would result in significant gains to the economy and to businesses that depend upon well-maintained highways and efficient movement of people. The program would provide a timely stimulus to desirable economic activity and ensure necessary investments in our transportation infrastructure. It also would produce a positive effect on employment.

Fourth, the proposal is fully consistent with both the Administration's user charge policy and its policy for national economic recovery. It would bring highway user charges, which have remained unchanged for more than 20 years, into line with current costs. Because revenues will be invested in an essential component of the economy's productive capacity, they will stimulate desirable economic activity and assist in meeting the Administration's economic goals.

The increased user charges will have a relatively modest effect on motor vehicle operators. The estimated average annual increase of $20 per vehicle operator household is relatively insignificant in comparison to the cost of owning and operating a motor vehicle. The average annual increase for all trucks (except pickups and vans) would be about $400 per year.

In the present budgetary and political climate, we are unlikely to obtain necessary increases in user charges for highways alone. It is even more unlikely that we could obtain approval for a separate user charge funded program increase for mass transit. However, by combining a restructured highway user charge system with higher program levels for both highways and transit, it may be possible to garner the necessary Congressional and industry support.

Although there are numerous benefits associated with the proposed, and long-overdue, increase in user charges, there are some potential drawbacks. Primarily, this proposal would be:

1. Perceived as an increase in Federal taxes;

2. Opposed by certain highway users who will not want additional user charge money to be used for transit; and

3. Opposed by certain Governors and other state officials because it could present them with difficulties in increasing state user charges.

RECOMMENDATION

That the Cabinet Council support this proposal to put our highway and transit programs on a sound financial basis by increasing highway user charges, beginning in FY 1983.

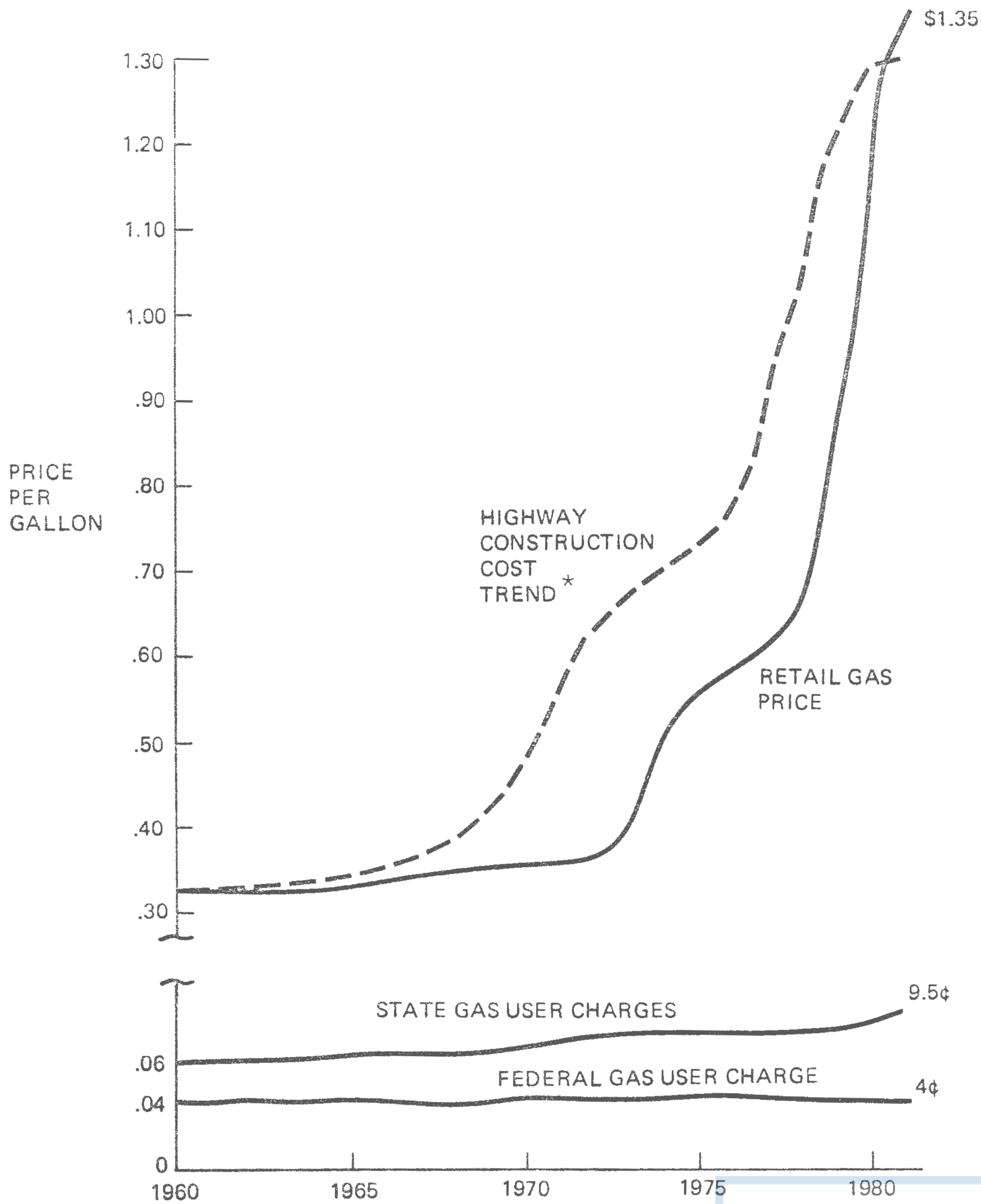
Table 1

FINANCIAL EFFECTS OF USER CHARGE PROPOSAL
($ Billions)

User Charges	FY 1983 Current	FY 1983 Proposed	FY 1983 Increase	FY 1983-86 Current	FY 1983-86 Proposed	FY 1983-86 Increase
Total Revenues*	$7.6	$13.3	+$5.7	$31.0	$54.6	+$23.6
Program Auth.	9.2	13.4	+ 4.2	38.5	57.6	+ 19.1
Outlays	8.4	9.2	+ .8	36.7	48.3	+ 11.6
Federal Budget Effect (Reduction in Federal Budget Deficit)	-.8	$ 4.1	+ 4.9	-5.7	+6.3	+ 12.0
Program Structure						
Federal Highway Aid	$9.1	$12.3	+$3.2	$38.1	$53.2	+$15.1
Federal Transit Aid	--	1.0	+ 1.0	--	4.0	+ 4.0
Other	.1	.1	--	.4	.4	--
TOTAL	$9.2	$13.4	+$4.2	$38.5	$57.6	+$19.1

*Includes Interest

COMPARISON OF TRENDS IN HIGHWAY PRICES AND USER CHARGES



- Retail gas prices have quadrupled since 1960.
- Over the same period, highway construction costs have risen by over 300%.
- States have responded by raising highway user charges by 60%.
- The Federal user charge of 4¢ per gallon, has remained unchanged since 1959.

* This trend line shows relative changes in the construction cost index