Turner Lecture

I have a working assumption that will seem unwarranted to most of you, but if you will suspend judgment for a bit, I would propose that this will be the last transportation reauthorization as we know it, and it might be the end of the federal surface transportation program as we know it. Why?

The battle over donor/donee status among the states. If the target is 95% return to all states of the gas taxes collected in their states, it will mean hurting the donee states if there is not a substantial increase in revenue to the trust fund. That will mean a gas tax increase that would go mostly to the donor states, not an easy task for the Congress. As a matter of the impact in the US Senate, most of the revenues in such an effort will go to about 20 senators, not enough to carry the chamber. This is not a partisan issue. Donor/donee is a line that divides the Senate in a way that makes it impossible to solve without a large increase in revenue. Someone asked me recently what is wrong with giving the revenue back to the states that produced it, and my answer was "this is still the United States of America". By the way, has anyone seriously assumed that each state gets back the US income taxes collected in their states? The reality of this issue is that our country has needs that transcend the needs of any individual state, but parochial greed will outweigh national purpose every time. The real problem with this issue is that it means that the program is just about revenue distribution, and not about national transportation needs. The forces behind this movement are so emotional and greed driven that I do not have much hope for a resolution that benefits the entire country.

The national transportation program had as its original mission a clear objective " To get America out of the mud", but it is now a revenue block grant to the states with no clear federal objectives. Most of the mission and purpose language in ISTEA was removed in TEA 21. The program is now about the national government collecting the revenues for the states and sending it back to them for limited national purposes, and no accountability for even those limited goals. This has made the logic of 95% return to each state almost inevitable. As a nation, we earlier had connectivity as an issue that literally kept us together. We still have critical national transportation purposes like world economic competitiveness in goods movement, security in the movement of our citizens, and safety for all the users of the system, but we cannot make those purposes fit into the authorization processes that we have created. How can the American public know what this program produces? If this program has no clear national purpose, other than revenue sharing, how can we expect the American public to support an expansion in the revenue base? The simple answer is that we cannot. There are several commissions proposed in this reauthorization bill that would examine future funding sources for the programs. I have a suggestion that they start by asking the question: "For What".

The insatiable demand for pork (or earmarked projects as the members like to call them) is destroying the credibility of the program in the public's mind. Members who say that they know how to better program transportation funding than their local communities or their state DOTs are making a mockery of the state and regional planning process. In addition to adding transportation projects, the number of earmarks for non-transportation projects has grown at an extraordinary rate. If the reauthorization process crosses the 5,000 project earmark number, the actual cost of the accumulated earmarks may exceed 20% of the annual program. The pressure to keep the costs of these earmarks above the apportionment numbers is already intense. If they stay outside of the program apportionment process, the pressure to load up on new earmarks will become even more intense. If there is continued growth in pork, the core programs will shrink. If there is no perceived integrity to the investment process then how can you get the American public to support increased revenue for the program? You cannot.

Gas tax revenues are slowing down. A Congressional Research Service report shows that US Trust Fund revenues (in 2001 dollars) fell from $21.2 Billion in 1999 to $20.9 Billion in 2002. On a longer horizon, CRS shows an increase in revenue (in 2001 dollars) from $20.8 Billion in 1997 to revenue of $20.9 in 2002. The revenues to the fund are not growing very fast, and may even slightly decline in the future.

Local referendums on gas tax increases are seeing some significant and visible failures. The recent referendums in Virginia and Missouri failed by unexpectedly wide margins. Is it an indication that the public has lost its belief in the viability of the transportation investment process? Most states have turned to a variety of debt instruments in the face of the political resistance to increasing gas tax revenue, but the combined impact of creative financing in states like New Mexico and New Jersey has been to rob those states of their future financial capacity. My old state, New Jersey, will apparently only have enough cash in its transportation trust fund to make principal and interest payments on it's debt next year, forgoing any local funding and with no ability to match federal funds

Increases in the federal funding levels for transportation have only led states and local governments to reduce the amount that they are spending on transportation themselves. From a recent GAO report: in 1991 the state and local investment in transportation spending was $29 Billion a year (in 2001 dollars). In 2002 the number was $35 Billion (in 2001 dollars), a 23% increase. During the same time period federal expenditures increased by 47% (from $20 Billion to $30 Billion). Since TEA21 the trend is even worse. From 1998 to 2002 (in 2001 dollars) state and local transportation investment decreased by 4%, from $37 Billion per year to $35 Billion per year, while federal transportation investment increased by 40% (from $21 Billion to $30 Billion per year). GAO says that the increases in the Federal program are leading to larger and larger reductions in state and local transportation expenditures. The GAO looks at what they call the substitution rate and they say that state and local governments reduced their program effort by only 18 cents for every $1 increase in federal program level in the 1980s. Today state and local governments reduce their transportation expenditures by 60-cents for every dollar of federal increase. In other words, a dollar of additional federal transportation spending today yields a 40-cent increase in total transportation expenditure. State and local governments now obviously see the funding of transportation investments as a federal role, particularly when it comes to setting and collecting the gas tax. The reason they feel this way is that state resistance to gas tax increases is as intense at the state level as it is at the national level. States carry an additional burden of keeping up with accelerating maintenance and operating cost, drawing their limited resources away from real capital investment.

In a recent issue of "The Journal of Urban Economics" Volume 55 (2004) 398-415, an article reviews the business rates of return on highway investments. The authors looked at the net gains in business productivity that were generated by highway investments over the last 30 years. The general finding was that highway investments generated rates of return that exceeded 15% in the 1970s, while those investments in the 1990s now yield less than a 5% rate of return. The authors point to the shift from capacity expansion to maintenance of the system, and to the increasing number of earmarked projects that have no rate of return. The article points out that an aggressive maintenance effort is necessary to keep the rate of return from slipping to the negative, which would happen if the existing system does not keep its current level of service. This finding is even more damaging if you look at the GAO finding on maintenance of effort that was mentioned above. The reality is that we are now getting a 5% rate of return on just 40 cents on the dollar of new federal transportation expenditures.

The increasing use of the sales tax, the property tax, and the income tax to fund transportation programs at the state and local level all break the linkages to the “user pays” concept. I believe that the strength of the federal transportation program has been the principal that user fees create the trust fund and the program is essential for national purposes. We have broken the link to national purpose and now in many areas we are breaking the integrity of the user pays concept that is essential to that “trust”. With debt mechanisms, general fund revenues, and other non-user fee based revenues we increasingly put at risk the “firewalls” that have protected the trust fund from budget pressures and constraints. If we venture very far from a user fee financed trust fund we will lose the integrity of the fund.

OK, lets look at what we have got here.
A food fight among the states over who gets back the money collected in their state.
There is an increasing dependence on non-user fee revenues to fund the trust fund.
There is no real national purpose for the funds being spent, so the program cannot be held accountable for its performance or outcomes.
Pork is here and it is uncontrollable. It will also probably soon is 20% of the program
Trust Fund revenues are slowing.
Local revenue is actually shrinking.
The more the Federal government raises revenues, the less States and local governments spend.
And last, but not least, the rate of economic return on highway expenditures has fallen drastically over the last decade or so. A terrible combination.

So?
The last time I tried to do transportation forecast was in 1979 when I was the Associate Administrator for the Policy, Planning, and Budget in FHWA. Re reading it now is a humbling experience, it teaches me to tread carefully about assumptions of linear progression. It is also possible to become a Cassandra and forecast doom in this process, which I have no interest in doing. Having said that, I will try to point to where these trends can go from here.

A recent ARTBA national poll shows that 66% of Americans would support an increase in the federal gas tax, if it were dedicated to transportation. That tracks with a number of other polls that have been taken on the subject over the last several years. A separate poll, done a while ago by AAA, showed that 62% of the surveyed drivers felt that increases in highway spending would not improve congestion in their communities or their commute. There is a disconnect here. I think that the public is telling us that if we get our collective act together, they will support increases in transportation funding. The idea that we are tolerating earmarks, that the program has no accountable national purposes, that these funds just belong to the states, that there is no accountability for maintenance of effort at the state and local level, all mean that the public is not sure of what it is buying with their tax dollars and is ambivalent about tax increases. Even the issue of the reauthorization as a jobs bill seemed to have no traction in the middle of an “economic soft spot”. We have to recognize that credibility gap and build a new confidence in the public about our collective stewardship of their transportation systems.

In terms of the funding future of the program, lets look at the options currently on the table:

1. The federal gas tax. This seems to be a no go right now. The current administration seems to be saying again, “read my lips”. If the program had more public trust, less pork, and more promised outcomes, the public might more aggressively support a major (?) tax increase of 5 cents or more, but it does not seem that the support is on the horizon. The opportunity for a gas tax was when gas was $1.35 a gallon. At $2.00 a gallon there seems to be no stomach for a gas tax increase. We are now stuck with a gas price that sends

huge amounts of US dollars overseas. With everyone arguing over getting their money back, no one is talking about what the funds are supposed to produce for the nation. Some form of rough equity among the states will not solve commute problems. The reduction of state and local efforts on transportation as the federal effort increases also directly undercuts the public's faith in raising taxes. If less than 40% of the new tax effort gets to the total program, why bother? The gas tax is the key to the integrity of the trust fund firewalls and the user fee approach that has protected the program for the last half century. Even with a different administration, I would rank the odds of a major gas tax increase to be less than 50-50.

2. How about creative financing and debt instruments. A number of the states have demonstrated the limits and perils of build now, pay latter financing. It is so tempting to elected officials to turn to debt when they get the credit for the construction and their successors get to pay for it. The line that Ronald Reagan used is appropriate here. When David Stockman told Reagan that his tax cuts would burden posterity, the President responded, " What has posterity ever done for me? " Even if we ignore the down side of the loss of the user pays integrity of the trust fund, there is still the reality of the debt capacity of both the national and state governments. Both are extremely limited. It is not likely that the US Treasury will agree to anything that makes the task of raising enormous amounts of debt more difficult in the immediate future. The states seem to be reluctant to increase their debt loads, and many could not if they wanted to. The prospect of increasing the "creative financing" stream of dollars to transportation seems very limited at best.

3. There is the hope that something like "public/private" partnerships will fill part of the void. This is at best a delusion, and at worst it is snake oil. The limited ability to toll certain corridors is not a public/private partnership, it is a toll strategy. It will not fill the $20 Billion a year gap in transportation funding that we need to fill. The expectation that there is any significant equity market to be tapped for transportation investments that have no revenue streams (other than tolling) is naive. There is no answer in public private partnerships.

4. Tolls. Any number of planners has set their sights on road pricing, corridor tolling and HOT lanes. There is one reality about tolling and that is that there is no federal role in tolls, other than removing restrictions on it. Imagine FHWA setting the toll rates for access to New York City. Three states and the city would revolt before that would happen. Tolls are uniquely a state and regional resource. There is no way to realistically make road pricing federal revenue, if only because the rates have to be set and collected at the local level. I do think that the revolution in toll technology makes road pricing the bright star for transportation financing, but I also believe that it is a state and local bright star.

Conclusions. There are limited prospects for an increase in the gas tax at the national level. Pork, donor/donee imbalances, and no national purpose in the program are very limiting. The best of all outcomes would be a conversion of the gas tax to a sales tax, thereby having the fund produce the necessary revenues to off-set the probable continuing declines in fuel consumption as the price continues to escalate. The necessary preconditions for that seem to be the creation of specific purposes that the public can understand and that states will be held accountable for. It will mean maintenance of effort requirement for the states. It would mean a dropping of the donor/donee issue, and it would make controlling and reducing the pork projects in each bill. I am not optimistic on any individual step, and think collectively it is an impossible task.

If tolls are a state resource, if debt financing is not a credible alternative, and states continue to reduce their commitment to transportation as federal expenditure increase, then I think that it is time to seriously consider an option that has been rejected out of hand in the past, and that is the reversion of the 18.4 cents federal gas tax to the states.
There are numerous advantages to the shift and a couple of serious down sides.

The advantages are:
First, the donor/donee issue goes away immediately. States can assume the tax, reduce it, or increase it by themselves.
Second, pork goes away. No federal appropriation, no ear marks.
Third, the issue of states reducing their level of transportation funding as the federal program increases goes away. States get the level of economic activity, system performance, and maintenance of effort that they need and that they deserve based on their own decision-making.
Fourth, the states will have a lot of extra incentives to crack down on gas tax collection fraud. The states are hit or miss on this issue over a long period of time and reversion would raise the stakes for states significantly.
Fifth, regulatory oversight and program complexity would be reduced by 2/3rds. Overhead costs for federal compliance could be slashed.
Sixth, the federal categories and program limitations go away. The states would be responsible for their own outcomes and more directly accountable to their constituents.
Seventh, states can create unified trust funds and allocate transportation revenues to investments that solve state problems like competitiveness in goods movement, and intermodal investments that are difficult now because of limits imposed on the use of funds.
Eighth, no more reauthorizations!

There are serious issues here.
System continuity still needs to be enforced. A very small number of engineers could do this now. There are so few new roads being built that the workload would be small. The authority to enforce system continuity is not funding dependent, it is based on the Commerce Clause of the Constitution.

Safety.
System safety is still a primary responsibility of the National Highway and Transportation Safety Administration. Federal safety authority is based on the ability to set guidelines, not necessarily regulations. States pay a great deal of attention to tort liability and that means compliance with standards, even if they are not mandatory.

Environment.
Conformity issues in non-attainment areas potentially become more difficult if the legal linkages between the Clean Air Act and Federal Transportation funds are eliminated. The Clean Air Act would have to stand on its own in enforcement by non-attainment region. There is still a powerful EPA role in transportation investment, even if the funds are solely state funds.

There are some serious downsides.

A number of the donee states would see a reduction in revenues if they did not increase the gas tax. There is no easy solution to this problem, and each state would wind up having to make some very tough choices about reducing their program or increasing revenues. There are about 6 states that would see a significant change in revenue.

The national transit program would see the loss of all of its general fund revenues and all of the trust fund revenues. It would mean that each system would have to work with its states to ensure adequate levels of funding. I recognize the difficulty of this transition, but something like this may be inevitable over the long term. Stagnation of federal gas tax revenues and the inability of the Congress to increase the gas tax in any meaningful way means that there will be constant pressure from the highway interests to reduce the transit allocation in the national program.

The loss of any national role in surface transportation. The executive branch of the national government has shown no interest in leading the country to new visions or programs in the critical areas of international competitiveness, intermodalism, or even a cooperative effort to creatively expand the transportation program's scope and reach. This is also not a partisan comment, since the decline of the USDOT has spanned almost 15 years and several Presidents. There is not much federal role here to loose. Perhaps the "laboratories of democracy" the states should see if they can provide a better stewardship of this vital national asset.

Conclusion: I am enough of a realist (or cynic) to know that changes like this do not occur in the United States unless there is a catastrophic failure of a system, and that the forces for the status quo, including the Congress, are incredible powerful. Having said that, it is time to start talking about the fact that the national transportation program is adrift and sinking under the weight of parochialism and greed. It is time to seriously look at the possibility that we need to devolve all surface transportation funding out of Washington. It is time to look at how we might do this incrementally over the next several decades, and we need to start asking these tough questions as soon as this reauthorization is completed. Just creating a serious alternative to the existing system will force a discussion about options other than the dead end ones we are now pursuing. If we have nothing better to offer the American public than unseemly parochial fights over who gets the money, and how many pork projects you can squeeze into a bill, then we should call the next bill G-CASH (Grab the Cash And Send it Home).