American Road & Transportation Builders Association
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Testimony before the
Senate Finance Committee
The Role of Tax Incentives in Energy Policy
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Introduction

Good morning, Mr. Chairman and members of the Committee. I am Pete Ruane, president and chief executive officer of the American Road & Transportation Builders Association (ARTBA), which is based here in Washington, D.C.

ARTBA, which will celebrate its 100th anniversary next year, has over 5,000 member firms and member public agencies from across the nation. They belong to ARTBA because they support strong federal investment in transportation improvement programs to meet the needs and demands of the American public and business community. The industry we represent generates more than $185 million annually in U.S. economic activity and sustains 2.2 million American jobs.

At the outset, I would like to thank Chairman Baucus for giving our industry an opportunity to testify at this important hearing. Your understanding of, and long time support for, transportation improvement programs and investment is deeply appreciated by the transportation and construction communities.

As context for my remarks, you should know that ARTBA believes the U.S. highway program must emphasize five principles:

1. Highway capital improvements should be financed primarily through the collection of highway user fees. And these fees, which should be levied and collected by government, must be adjusted as necessary to provide an adequate source of funding for the highway, bridge and mass transit improvement program.

2. Safety must be a paramount concern in the design, construction, maintenance and traffic operations of the nation's highway system.

3. Critically deficient bridges should be repaired or replaced.

4. Improved rideability and pavement durability should be program goals; and

5. The capacity and efficiency of the highway system should be improved as necessary to meet public demand and the needs of the economy.

In line with our support for the user-fee concept of financing surface transportation improvements, we also believe all energy sources utilized to power motor vehicles that use the nation's highway and bridge system should be taxed to pay for system improvements through the federal Highway Trust Fund. The current investment needs of our highway system dictates that the excise on such motor vehicle powering sources should be at least equivalent to that currently levied on gasoline.

These views are supported by virtually all state and national organizations representing highway transportation and construction concerns.

The Tax Nexus Between Federal Transportation, Energy, Environmental Policies

My primary purpose today is to bring to your attention the unique nexus between federal transportation, energy and environmental policies. Policy in all three areas have a common thread—the use of federal tax law involving motor fuels to advance national objectives.

Unfortunately, these tax policies are often debated and decided separately and thus in a vacuum—during a transportation bill… an energy bill… or an environmental bill. As a result, positive impacts for one policy area sometimes contradict—or even undermine—goals and objectives in another policy area.

The federal government first levied a highway user fee on the sale of motor fuels in 1956, when it established the federal Highway Trust Fund. The original congressional intent in establishing the user fee—an excise on gasoline and diesel fuel—is clear: to ensure that America would have a "pay-as-you-go" system for funding needed highway and bridge improvements.

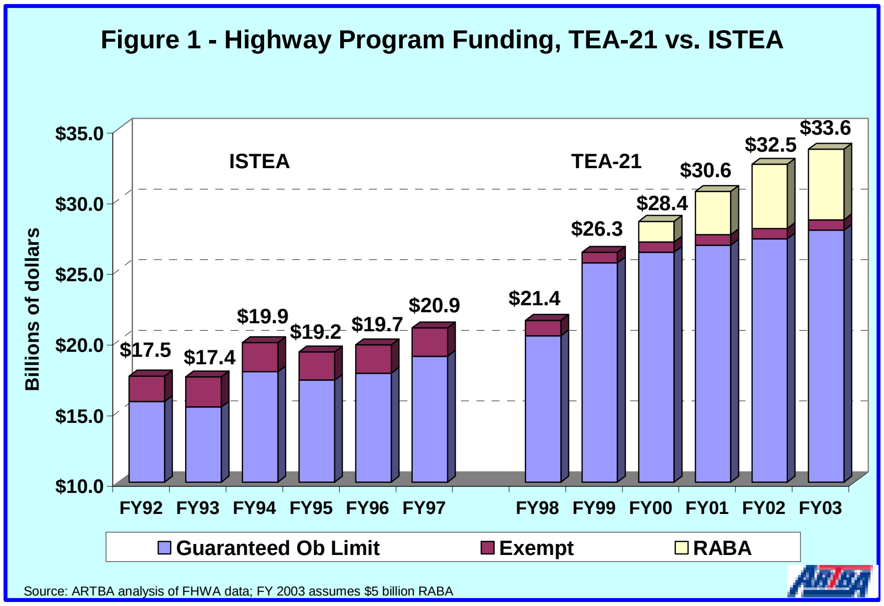
The principle was—and remains today—that the more you drive, or use the roads, the more you pay to build and maintain them.

This user fee principle was reaffirmed by the Congress in 1998 with the enactment of the Transportation Equity Act for the 21st Century, or TEA-21.

Unfortunately, current public investment in road, bridge and mass transit improvements financed by highway user fees levied at all levels of government is not sufficient to maintain the physical conditions of the system, much less improve its overall performance for the American public and business community.

Status of the Nation's Highway Network

Under the landmark TEA-21, federal highway investment will have averaged just under $29 billion per year by the time the program expires in 2003. This represents a substantial increase over the funding provided under the Intermodal Transportation Efficiency Act of 1991 (ISTEA), as Figure 1 demonstrates.



Under TEA-21, however, investment by government at all levels has barely been enough to maintain the physical condition of the nation's highways and bridges, according to the U.S. Department of Transportation's (U.S. DOT) 1999 biennial report on the condition and performance of the nation's highways, bridges and transit systems. Worse, investment has fallen far short of the amount needed to maintain travel times and prevent traffic congestion from increasing, which are of equal, if not greater, importance to highway users.

While the nation's roadway and bridge network has benefited from increased investment over the past decade, the system still has enormous, unmet capital needs. The 1999 U.S. DOT report articulates the following challenges that must be addressed:

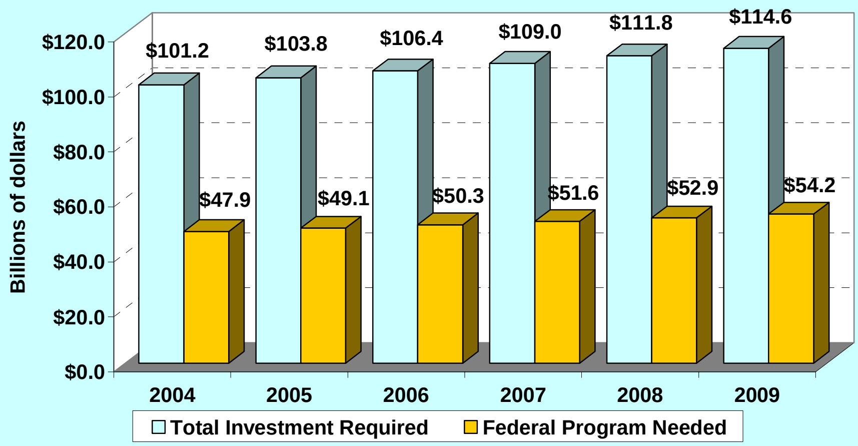
- **Twenty-eight percent of all arterial road miles in the U.S. are in "poor" or "mediocre" condition.** The situation is worst on the nation's heavily traveled urban interstates, where 36 percent of the pavement mileage is classified as in "poor" or "mediocre" condition.

- **Thirty percent—172,572 U.S. bridges—are either "structurally deficient" or "functionally obsolete."** That includes more than one out of every four bridges (27 percent) on urban interstates.

- And highway congestion is a growing concern. **Fifty-three percent of urban interstate highway miles are congested during the peak travel hour.** In the nation's 68 largest urbanized areas, 64 percent of all travel occurs in "moderate" to "extreme" traffic congestion, compared to only 35 percent in 1982. **This congestion costs the U.S. economy more than $78 billion each year,** more than triple the $22 billion cost in 1982. Perhaps even more distressing is the cost traffic congestion is imposing on the quality of life for American families.

Based on data published in the U.S. DOT report, adjusted to reflect historic levels of traffic growth and OMB's estimate for future inflation, the minimum level of investment required by all levels of government in 2004, the first year of TEA-21's successor legislation, to simply maintain both the current physical condition and performance of the nation's highway and bridge system, would be $101.2 billion. This is more than $40 billion more than the $59.5 billion that was actually spent in 1999 by all levels of government combined. By 2009, the necessary investment would grow to $114.6 billion. The annual figures are shown in Figure 2.

Figure 2 - Investment Needed to Maintain Highway and Bridge Travel and Physical Conditions



Source: ARTBA analysis of FHWA data

Today, the federal government funds almost 45 percent of all state and local capital investments in road and bridge improvements. The 1999 U.S. DOT report to Congress, therefore, suggests that **a $50 billion per year federal highway program is necessary just to maintain the system conditions and performance levels detailed above** over the period 2004-2009, which is the expected duration of the next federal surface transportation authorization bill. This is $17 billion per year more than the expected federal highway investment in 2003. The annual figures for these investment requirements are also shown in Figure 2. **To actually improve highway and bridge system conditions and performance, the U.S. DOT report suggests a $65 billion per year federal highway program would be necessary**.

Promoting Alternative Fuels and the Highway Trust Fund

Clearly the intent of Congress in enacting TEA-21was to make surface transportation investment a federal priority. But you should be aware as the Congress discusses and debates a new federal energy policy in the weeks ahead that some current federal energy and tax policies work against the goals of TEA-21.

For example, the purpose of the Energy Policy Act of 1992 (EPAct) was to accelerate the use of alternative motor fuels in the transportation sector—certainly a laudable goal from energy independence and perhaps even environmental standpoints. EPAct's stated goal is to replace 30 percent of petroleum-based motor fuels by the year 2010.

EPAct defines as an alternative motor fuel the following: methanol and denatured ethanol as alcohol fuels (alcohol mixtures that contain no less than 70 percent of the alcohol fuel), natural gas (compressed or liquefied), liquefied petroleum gas, hydrogen, coal-derived liquid fuels, fuels derived from biological materials and electricity (including solar energy). Under the law, the U.S. Department of Energy can expand this list when new fuels are developed.

What impact would reaching such a laudable goal have on federal funding for highway and mass transit improvements? If the motor fuel sources are not taxed equivalently to gasoline, <u>the impact would be devastating to highway and mass transit programs in all states</u>!

Consider the impact of the current federal tax treatment of ethanol-gasoline motor fuel blend sales. And I must make clear ARTBA has no brief against the promotion and use of ethanol as a motor fuel beyond the way it impacts the Highway Trust Fund.

Current Federal Tax Treatment of Alternative Fuels

A motorist purchasing gasoline contributes 18.3 cents per gallon to the Highway Trust Fund through the federal user fee—15.44 cents per gallon to the trust fund's Highway Account and 2.86 cents per gallon to the fund's Mass Transit Account. (An additional 0.1 cents per gallon is contributed to the Leaking Underground Storage Tank Trust Fund.)

Under current federal law, a motorist purchasing gasohol (with 10 percent ethanol), however, pays a 13-cent per gallon excise, or 5.4 cents per gallon less than those who purchase straight gasoline. A slightly higher excise is applied to gasohol sales with less ethanol. Of the 13 cents per gallon federal excise paid on a gallon of 10 percent gasohol, a user fee of 10.4 cents per gallon goes into the Highway Trust Fund—7.54 cents per gallon to the trust fund's Highway Account and 2.86 cents per gallon to the fund's Mass Transit Account. Two-and-a-half cents is deposited in the federal General Fund for deficit reduction purposes. (There is also a 0.1 cents per gallon contribution to the Leaking Underground Storage Tank Trust Fund.)

The combination of the 5.4 cent per gallon tax incentive for 10 percent gasohol and the 2.5 cent per gallon contribution to the general fund reduces deposits in the Highway Trust Fund Highway Account by 7.9 cents per gallon sold. (It is also worth pointing out that the Mass Transit Account of the Highway Trust Fund receives the same contribution from either the purchase of gasoline or gasohol. This means the cost of federal policies to promote the use of ethanol fuels comes exclusively at the expense of the Highway Account.)

As a result of TEA-21's provisions that directly link incoming Highway Account revenues to annual federal highway and bridge investment, the ethanol tax incentive has a direct consequence of making less revenue available for investment in needed highway and bridge improvements.

Impact of Alternative Fuel Incentives on Federal Highway Investment

The most current example of the impact of alternative fuel tax incentives on federal highway investment is the case of ethanol-based motor fuels. The computations in Table 1, based on 1999 ethanol use data reported in the Federal Highway Administration's "1999 Highway Statistics Report," show current federal tax policy on ethanol motor fuel sales results in approximately $1.1 billion per year of foregone Highway Trust Fund Highway Account revenues. Of the $1.1

billion, roughly $700 million per year is attributable to the 5.4 cents (10 percent ethanol) and 4.16 cents per gallon (less than 10 percent ethanol) tax incentive for gasohol and approximately $400 million is due to the 2.5 cents per gallon of the gasohol excise that is deposited in the federal general fund.

To put this number in perspective, it is roughly equivalent to total federal investment in Florida's state highway program in FY 2001 and four times the annual amount of federal highway formula funds received by the state of Montana.

Table 1

10 percent gasohol usage (gallons)	9,318,049,000
5.4 cents per gallon tax incentive	$503,174,646.00
2.5 cents per gallon to General Fund	$232,951,225.00
Lost Highway Account Revenues	$736,125,871.00
Less than 10 percent gasohol usage*	4,870,796,000
4.158 cents per gallon tax incentive	$202,527,697.70
2.5 cents per gallon to General Fund	$121,769,900.00
Lost Highway Account Revenues	$324,297,597.70
Total Lost Highway Account Revenues	$1,060,423,468.70

*According to the U.S. DOT, less than 10 percent gasohol is generally a 7.7 percent blend

Federal tax treatment of ethanol-based motor fuels impacts individual states differently. TEA-21's highway funding distribution formula requires the apportionment of Interstate Maintenance and Surface Transportation Program funds to be based, in large part, on a states contribution to the federal Highway Trust Fund's Highway Account. States that sell ethanol-based motor fuels are, therefore, at a relative disadvantage to states that don't. States that sell more ethanol than other states that also sell ethanol are also at a competitive disadvantage.

This problem was articulated at a June 14, 2000, Senate Clean Air, Wetlands, Private Property and Nuclear Safety Subcommittee hearing. Gordon Proctor, director of the Ohio Department of Transportation, testified on the impact ethanol's federal tax treatment has on his state's federal highway apportionments. Ohio motorists were the third largest purchasers of ethanol-based fuels in the nation in 1999, behind those in Illinois and Minnesota.

Mr. Proctor said, "[b]ecause ethanol-blended fuel is taxed differently from petroleum fuels, the increase in ethanol use has significantly decreased the amount of revenue credited to Ohio in the Highway Trust Fund." Ohio's federal formula funds are thus, he said, reduced by $185 million annually.

The Minimum Guarantee mechanism of TEA-21 helps mitigate this situation, but Ohio has not fully shared in the increased highway investments due to TEA-21's revenue aligned budget authority (RABA) provision that requires all user fee receipts above the level anticipated by

TEA-21 to be invested in the federal highway program. The same situation is true in some other states.

Tables 2 and 3 (on pages 9 and 10, respectively) are from the Federal Highway Administration. They detail the current federal tax treatment of gasoline, diesel and alternative motor fuels, and the current use of ethanol-based motor fuels by the states.

Recent Developments

There are roughly 20 bills pending in Congress that would further promote the use of ethanol. Some of these measures would phase out or ban methyl tertiary butyl ether (MTBE) and functionally or statutorily require an increase in the use of ethanol. While I am not qualified to comment on the merits of MTBE or ethanol, I can assure you that requiring an increase in the use of gasohol would also increase the amount of lost revenues to the Highway Account and, therefore, further diminish the nation's ability to meet its highway infrastructure needs.

The developing situation in California could also further impact this dilemma. As a result of the state's decision to phase out MTBE and the Bush Administration's decision to not grant California a waiver of the federal oxygen content requirement for reformulated gasoline, some are projecting the state will increase its use of ethanol from 150 million gallons to 580 million gallons. If these projections are realized, the amount of lost Highway Account revenues due to the ethanol tax incentive will be increased.

Transportation leaders in a number of states have already indicated to us that when Congress takes up the reauthorization of TEA-21 changing the highway apportionment formula to make up for lost revenues by large ethanol consuming states will be a top priority.

Recommendations

The nation is at a critical juncture.

It is clear America needs to reduce its dependence on foreign energy sources that power our U.S. transportation fleet.

It is clear that meeting federal air and water quality standards without compromising American mobility and the economy will require even cleaner transportation vehicles and motor fuels.

It is also clear that America has a growing transportation infrastructure capacity crisis—not just in the road network, but also in our airport, water port, rail and mass transit systems. If we do not meet our transportation network challenges, we will also compromise American mobility, air and water quality goals and the U.S. economy.

Mr. Chairman and members of the Committee, as you develop the tax portions of a new national energy policy… or environmental policy… we urge you to ensure that federal funding for much needed transportation improvements is not shortchanged in the pursuit of promoting use of alternative motor fuels.

And we will support you in any legislative effort that seeks to address the concern we have raised.

As a short-term measure, we respectfully suggest that since the federal deficit has been successfully addressed by the Congress there is no further need to impose a 2.5 cent per gallon tax on gasohol for the General Fund. We encourage you to redirect this revenue stream—which generates roughly $400 million per year—to the Highway Trust Fund's Highway Account as a highway user fee.

Finally, we urge that Congress initiate a comprehensive study that recommends financing mechanisms for federal highway and mass transit investment in the future, post-gasoline and diesel era. Perhaps Global Positions Technology should be used to charge user fees based on mileage driven or maybe autos and trucks should have a usage meter like we have for public utilities. There are many options that should be carefully explored. We need to prepare now for future transportation financing needs.

Mr. Chairman, that concludes my testimony. Again, thank you for the opportunity to present our views to the Senate Finance Committee. I will try to answer any questions you or other Committee members might have.