

**REVENUE ISSUES RELATED TO THE
HIGHWAY TRUST FUND**

HEARING

BEFORE THE

**COMMITTEE ON FINANCE
UNITED STATES SENATE
ONE HUNDRED SEVENTH CONGRESS**

SECOND SESSION

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MAY 9, 2002
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Printed for the use of the Committee on Finance

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U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 2002

85-814—PDF

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REVENUE ISSUES RELATED TO THE HIGHWAY TRUST FUND

THURSDAY, MAY 9, 2002

U.S. SENATE
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:35 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee), presiding.

Also present: Senators Jeffords, Graham and Grassley.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. Hearing will come to order. I welcome everyone this morning. I know this is a bit of a different cut than what the Finance Committee usually does. And I appreciate very much your taking the time to prepare something a little bit different than what we might otherwise do. I say all that because this committee has not ever had a hearing on the relationship between the trust funds and authorizing legislation. I thought though that given the Finance Committees jurisdiction and oversight responsibilities over the trust funds, that it is incumbent upon this committee to examine those funds and do our best to make sure that they are working the way that we think is in the public's interest.

As we approach the re-authorization of both TEA 21 and AIR 21, the finance Committee will examine the taxes, the revenues and the balance projections that will be the basis for both the Federal Highway and Aviation Programs over the next several years.

Before I get to the nuts and bolts of the hearing, let me first say how pleased I am to see my good friend Senator Grassley from Iowa here this morning. He and I come from somewhat similar States—agricultural States—somewhat in the middle of the country and we also have views that are very similar. It's a real joy to work with Senator Grassley and I know how interested he is in transportation issues as well. Iowa just like the State of Montana is quite rural, there's lots of highways and working with those similarities I hope to find similar solutions.

I also want to thank Senator Jeffords. Senator Jeffords is chairman of the Environment and Public Works Committee. And we will work very closely together, cooperatively, as he in that committee, writes the next highway bill. But since this committee has jurisdiction over the funds that go into the highway trust fund, I think it would be appropriate for us to be working together.

I served on that Committee that Senator Jeffords is the Chairman of, for about 20 years—working on both ISTEPA and TEA 21. I can tell you highway re-authorization bills are an integral part—at least in my State—of our economic development plan. That highway program creates 11,000 jobs in my State of Montana, and those are good paying jobs. It's not only building good highways, good infrastructure, but it's also jobs that help so many of our Americans.

We hope to improve upon the highway program by diverting and adding more revenues to the various trust funds. There are three ways I think that we can do that.

One is the 2½ cents that goes into the general fund from the sale of gasohol. I introduced a bill, S. 1306 that transfers 2½ cents to the Highway Trust Fund. I am happy to report that S. 1306 (also known as the Highway Trust Fund Recovery Act) was included in the Energy Policy Act which the Senate passed just recently and I am hopeful that that will become law by the time that we introduce the re-authorization bill.

The second provision in my proposal involves the ethanol subsidy and funds lost to the Highway Trust Fund. Currently the Highway Trust Fund subsidizes ethanol. Now I am a strong ethanol supporter. Ensuring necessary and affordable energy supplies including ethanol-blended motor fuels and other initiatives, is important I think, to our quality. Policies to achieve these objectives should not come at the expense of transportation infrastructure improvements. After all cars that utilize gasoline use our highways just like cars that utilize gasohol. Whether it's gasohol or gasoline, they still drive on our highways and it's my view that the funds that derive from driving on the highway should go to the Highway Trust Fund and not into general revenue.

Therefore, in my re-authorization proposal, I plan to include a general fund transfer for the 5.3 cents lost to the Highway Trust Fund from the ethanol subsidy. Just to be clear the subsidy does stay in place but there is equity created between the general fund and the Highway Trust Fund.

By directing both the 2½ cents and the 5.3 cents to the Highway Trust Fund, I think we can alleviate a growing problem for many States—that is lower trust fund contributions and therefore lower highway apportionments. I might add, I was struck several years ago—and I know it's still the case—the Federal Department of Transportation did a study of highway needs in America and concluded that the program meets only about 50 percent of the needs in our country. There is huge need for more dollars for bridge construction, railroad crossings, highways, transportation corridors, repairs. It's actually quite stronger than I think most people realize.

The third provision I will include in my bill will be recouping the interest from the balance in the Trust Fund. Prior to TEA 21 interest on the Trust Fund was included in the balance. I think that interest should be again, retained for the Trust Fund.

These three provisions will ensure that much needed highway improvements are made throughout the country. Specifically, it means more jobs for not only people in my State, but across the country.

In addition I want to look at the RABA issue, that is, how RABA is presently calculated. A few questions about the calculations made by Treasury, the IRS and the CBO projection of balances. Maybe there's another way we can make those calculations and estimates so that there's not such great volatility as we are currently experiencing. Some say it's up close to 9 billion dollars of difference because of RABA calculations. My thought is it would be better if we could even that out a little bit, if there is a way to do so, so that we avoid the highs and lows that we are now experiencing and trying to find solutions to.*

That concludes my general remarks. We will have a good number of questions. I would like to now turn to ranking member of the committee, Senator Grassley.

**OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S.
SENATOR FROM IOWA**

Senator GRASSLEY. Thank you very much Mr. Chairman and thank you also for your recognition that Iowa and Montana have similar approaches to these highway issues.

Now that you are Chairman of the Senate Finance Committee, people may forget about all your activity on highway trust funds throughout your career in the United States Senate. I want to thank you for your leadership in that area when you had another capacity in the United States Senate because obviously you have been in the middle of this issue for a long, long time, even before becoming chairman of this committee.

As Congress approaches re-authorization of TEA-21, it is important for us to evaluate the overall health of the highway fund. This hearing will help our evaluation—help us evaluate all revenue sources of the fund to determine if adjustments are appropriate and to determine if adjustments are appropriate in the way that we actually spend those Highway Trust Funds.

A number of issues are important. We should be working with Treasury and Internal Revenue Service to improve the quality and timeliness of tax return information that report the excise taxes. I hope the Treasury and The Service will pledge a time line to schedule converting tax returns for excise taxes to an electronic system of reporting.

I was disappointed in the volatility of current estimates because Treasury may have been dealing with statistics that were over 6 months old. Not only did these statistics not take into account the beginning of the recession, March 2001, but failed to predict the devastating affect of September the 11th on the American consumer spending less money on travel. Obviously recession and a national crisis are not things that are generally built in to estimate baselines, but more timely electronic reporting would help give more accurate real time estimates.

Also of concern is the ongoing evasion of excise taxes. If we are going to base our entire system on dedicated funds, we must also focus on aggressive enforcement if evasion schemes are suspect. This committee has previously focused several hearings on the

*For more information on this subject, *see also*, "Overview of Highway Trust Fund Excise Taxes and Related Internal Revenue Code Expenditure Provisions," Joint Committee on Taxation staff report, May 9, 2002 (JCX-37-02).

issue of what we call schemes, scams and cons which degrade the integrity of the tax system.

The outright evasion of excise taxes hurts the ongoing safety of our American highway system besides being morally and legally wrong in its own right. Today more than ever after the crisis of September 11th the safeness, soundness and security of highway systems across all of the States is critically important. This nation needs safe highways and so long as we cannot utilize the general fund to pay for our highways then we must aggressively guard our dedicated taxes.

And speaking of guarding our excise taxes, I have a second opportunity to thank Chairman Baucus for the amendment that I supported as ranking member and added to the Energy Tax Incentive Act of 2002. Under that we will transfer 2½ cents collected from gasohol out of the general fund to be rededicated to the Highway Trust Fund. This is something that I have wanted to do and it should have been done since 1998. I understand that our witnesses today will be doing some forecasting as to the effects that this 2½ cent transfer may have on the Trust Fund in the future. This committee and Senate Energy Committee—particularly the bill from Senate Energy—also actively support additional incentives for alternative vehicles, alternative fuels and substantial increases in fuel efficiencies.

Since the Senate has spoken as to the importance of these policies, we must consider whether a totally dedicated trust fund might need some rethinking. And we may need to ask some hard questions about dedicated funds. Should we continue to use a fuel excise taxes for instance to fund a leaky underground storage fund. And I could raise a lot of other questions about just formulas generally. But those will be issues that we will touch on during the debate, but I am also suggesting that we should touch on them.

As Congress continues to encourage fuel efficiency and alternative fuels, we need to review how the dedicated funds of the Highway Trust Fund are allocated.

I know I have also asked today's witnesses to discuss simplification. A few months ago when I was chairman of the committee we devoted an entire hearing to simplification of the tax system. And I know our chairman shares ongoing concerns that I have that the tax system is very complex and we should strive to clarify and simplify the tax system.

As we review the future of the Highway Trust Fund, these are all issues that will remain important to me. And I thank the chairman for holding the hearing. I explained to him privately that I will not be able to stay at this hearing because of some caucus responsibilities that I have. But I appreciate the opportunity to make my statement and I obviously will strive to work with you on whatever we do in this area, even though it may be next year.

The CHAIRMAN. Thank you very much Senator Grassley. I deeply appreciate your hard work and cooperation. Thank you very much.

I'd like to turn it over to the chairman of the Environment and Public Works Committee, Senator Jeffords, who is taking over huge responsibilities—and I know fiercely looking forward to them—and I extend to him my pledge to work cooperatively with him on these and other issues.

**OPENING STATEMENT OF HON. JAMES M. JEFFORDS, A U.S.
SENATOR FROM VERMONT**

Mr. JEFFORDS. Thank you Mr. Chairman for those kind words and let me commend you for holding this important hearing. And thank you for permitting me to make my opening remarks.

I look forward to working closely with you both here on the Finance Committee and on my committee on Environment and Public Works.

Recent events make clear the need to focus on the Highway Trust Fund and its management. The President's budget proposed for fiscal year '03 with its proposed reduction in spending on the highway program has created enormous concern and confusion among the 50 States and the businesses and individuals who rely on the transportation system. That is why I introduced as 1917 the Highway Restoration Act, a bill originally co-sponsored by all 19 members of the EPW Committee. Under S. 1917—which now enjoys 74 co-sponsors—the program will be funded at least the level authorized.

My near term goal for S. 1917 are three fold. First to secure the highest level of funding possible for the highway program for fiscal year '03. In that regard I work with the Budget Committee to define a program amount that will fit within their overall budget constraints. I support the Budget Committee's 5.7 billion dollar level.

Second, provided that the necessary budgetary caps can be established I would like to see the fiscal year '03 funding protected by fire walls.

Third, I want to be sure that whatever additional funds are made available to the program are distributed along TEA-21 formulas.

In the long run, I want to improve the Revenue Allying Budget Authority (RABA) to avoid this problem in the future.

Today's hearing on the highway trust fund is also timely as we embark on authorization of the nation's surface transportation program. Throughout the interstate highway era, our National program has been supported by the Highway Trust Fund. The Trust Fund has sustained the program for nearly 50 years. Over this period we have witnessed exponential growth in the use of gas and diesel fuel powered vehicles, generating ever increasing revenues for the Highway Trust Fund.

In today's Finance Committee hearing we will discuss projections for that fund. These projections will guide the EPW Committee's work on future surface transportation policy, program structure and funding levels.

Mr. Chairman, as you know due in large part to your efforts, the programs funding grew by roughly 40 percent during the last authorization TEA-21. This was achieved by directing gas tax revenues to the Trust Fund that had formerly gone toward deficit reduction.

As we proceed with the re-authorization we must seek new ideas to grow the program. I do not anticipate another 40 percent growth from traditional sources. That is why I am so excited about our joint EPW-Finance hearing this Fall to examine innovative finance concepts. Modest Trust Fund reflects changing travel trends and tight economic times. We need new ideas to confront these new challenges.

Mr. Chairman, I look forward to working with you over the coming months. All those interested in the strong and well funded transportation program need to pull together. These tight times will require strength through unity, a national perspective, and a spirit of cooperation. With that let me close again and thank you Mr. Chairman for leading the hearing today, listening to me and I look forward to working with you, we have quite an adventure ahead of us.

The CHAIRMAN. Indeed we do and I thank you very much Senator and thank you for mentioning the joint hearing we plan to hold this Fall. I think that will be most constructive. I deeply appreciate your help here.

Now I will turn to the witnesses. Let me announce each of them. First we will hear from Dr. Drew Lyons from the United States Department of Treasury. Next Ms. Jayetta Hecker from the General Accounting Office, and last but—as the saying goes—not least we will have Kim Cawley from the Congressional Budget Office.

Since we don't have a large number of witnesses today, I'd like each of you to speak not 5 minutes, but say 10 minutes if you want to speak that long—shorter if you wish—but certainly you can have 10 if you want to fill up the time. So why don't you begin Mr. Lyon, Mr. Lyon or Lyons?

Mr. LYON. Lyon, no "s."

The CHAIRMAN. Singular, okay thank you.

OPENING STATEMENT OF ANDREW LYON, DEPUTY ASSISTANT SECRETARY FOR TAX ANALYSIS, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. LYON. Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you today. With your permission I would like to read a shorter version of my testimony and submit the full testimony. In my testimony, I will first describe recent trends in highway-related excise taxes.

Second, briefly describe how funds are credited to the Highway Trust Fund. Third, highlight areas the Treasury is evaluating as part of its ongoing simplification project. And forth, discuss the administration's fiscal year 2003 budget forecast of related excise tax.

To begin, let me first review trends in recent excise tax receipts for the highway account. As has been mentioned, there was a rapid downturn in highway related excise taxes as the economy began weakening in the Summer of 2000 and continuing through 2001. Tax receipts into the highway account fell 3.4 billion dollars between fiscal year 2000 and fiscal year 2001. Dropping from 30.3 billion dollars to 26.9 billion dollars, an over 11 percent decline.

As shown in the table accompanying my testimony, 5 of the 6 receipt sources were lower in 2001 than in 2000. Only taxes on gasohol fuels show an increase. The increase in taxes on gasohol fuels is evidence of an ongoing substitution of gasohol fuels for gasoline, which may be used interchangeably in cars and light trucks.

We anticipate that there will be an increasing use of gasohol fuels, as a proportion of total fuels, as States ban the use of MTBE as a fuel additive. Since the highway account receives 15.44 cents per gallon of gasoline, but only about 8 cents per gallon of gasohol,

the substitution of gasohol fuels for gasoline will result in a net reduction in highway account receipts.

Looking at the other excise tax sources, the most dramatic declines between fiscal year 2000 and fiscal year 2001 (both in percentage terms and in dollars) occurred in excise taxes related to the sales and operations of trucks. The reductions in retail truck taxes were particularly large, because this tax is levied as a percentage of the sales price on the first retail sale.

During the investment boom of 1998 and 1999 a large volume of new trucks were purchased at premium prices. As the economy weakened, reduced demand for new trucks, coupled with large numbers of these slightly used trucks on the secondary market, depressed prices and sales in the new heavy truck market. Tax revenues from retail truck taxes declined accordingly.

In terms of the administration of the trust fund (how excise taxes end up being credited to the Highway Trust Fund), motor fuels account for more than 90 percent of trust fund receipts. These fuels are taxed when they move out the bulk transportation storage network and into tanker trucks at the terminal rack. At this point the fuel is taxed (or in the case of diesel or kerosene intended for non-taxable purposes), it is dyed. The owner of the fuel as it passes the terminal rack, known as the registered position holder is liable for payment of tax.

Tax payers with more than 2,500 dollars in net excise tax liability are required to make semimonthly payments. These taxpayers typically rely on safe harbor rules in determining the amount to deposit. These deposits are typically made via the electronic Federal tax payment system. Initially these collections are deposited into the Treasury's general fund. At the time of the deposits, tax payers are not required to itemize which excise taxes they are depositing, they simply indicate that it is for excise taxes. This deposit may be for any of approximately 50 different excise taxes.

Even tax payers that exclusively owe taxes on motor fuel, are likely to have tax liability for a combination of gasoline, diesel, kerosene, gasohol and possibly various alternative fuels. Each of these fuels is taxed at different rates and distributed in different proportions to different accounts. The two accounts of the Highway Trust Fund, the Leaking Underground Storage Tank Trust Fund and the General Fund.

In the absence of sufficient information from the tax payer regarding the composition of excise tax deposits, tax receipts appropriated to the Highway Trust Fund are estimated as called for in section 9601 of the Internal Revenue Code. Thus on a semimonthly basis, the Office of Tax Analysis of Treasury allocates incoming excise tax receipts based on historical liability shares as an estimate of the amounts appropriated to the Highway Trust Fund.

Tax payers will report their tax liability for most excise taxes quarterly on form 720. This form is due 1 month following the close of the quarter. The excellent pamphlet prepared by the Joint Committee on Taxation for today's hearing includes a copy of this tax form in the appendix.

On the form 720, taxpayers itemize their liability. For example, reporting the numbers of gallons of each fuel and the tax due and

claims of non-taxable use of the fuel. Any balance due or over payment is settled at the time the form 720 is filed.

Taxpayers separately report liability for the heavy vehicle use tax on form 2290. In general payments must be paid in full with return or in quarterly installments. In conjunction with these tax forms, the IRS calculates the Highway Trust Fund certification of taxes collected for the quarter. After processing the excise tax return, the IRS compares the reported tax liability with the deposits received from each taxpayer. In cases where taxpayers have reported tax liability exceeding their deposits, deposits are allocated based on their prorated tax liability to ensure that certified amounts equal tax collections. In order to allow time for late filing by taxpayers, amended returns or adjustments from examinations, the certification is issued approximately 4½ months following the due date of the return. The certified amount is then compared to the amounts transferred as estimated.

Reconciling adjustments are made to the Trust Fund Accounts for any differences between the certified amounts and the amounts previously transferred.

I would now like to turn to discuss certain administrative and compliance difficulties with highway excise taxes. Maintaining the flow of receipts into the Highway Trust Fund requires continuing efforts to secure better tax compliance. Over the last decade there have been three major compliance success stories.

First, moving the point of taxation for motor fuels to the terminal rack, significantly reduced opportunities for tax evasion. Second, requiring diesel fuel, home heating oil and other diesel subsidies to be dyed red to be sold tax free eliminated another source of evasion. Third, taxing undyed kerosene on the same basis as the regular diesel fuel with which it is often mixed, has reduced other evasion opportunities.

Combating fuel tax evasion occurring outside the main distribution network is a continuing effort of the IRS in cooperation with State tax authorities. Untaxed kerosene (intended to be used in aviation fuel) "transmix" taken out of pipelines, waste vegetable oils, used dry cleaning fluids and other chemicals, may be mixed with diesel fuel and find their way into the fuel tanks of trucks on the road. New initiatives are under way to combat this form of evasion.

One is a detailed computerized information system developed in cooperation with the petroleum industry and the States, that will allow all fuels to be tracked from the refinery gate all the way through the distribution system. Another is fuel fingerprinting, a technique that tests samples taken from retail stations for adulteration or for a mismatch with samples taken from the terminal racks that normally supply those stations.

These continuing efforts are supported in part by a small appropriation from the Highway Trust Fund of monies used specifically for compliance efforts.

Other taxes can result in significant compliance burdens. For example, the annual use tax involves all owners of heavy highway vehicles and imposes compliance burdens on taxpayers, the IRS and State agencies. Some vehicle owners evade full compliance by paying only the first quarter's tax, but not subsequent installments.

The retail truck tax is particularly difficult to administer and compliance is particularly difficult for truck dealers and other as it requires a number of factual determinations.

The Treasury Department expects to announce proposals to both simplify and improve compliance with excise taxes that support the Highway Trust Fund as part of its ongoing simplification project.

Before I close, I would like to briefly describe the administrations forecast of future excise tax receipts. Looking forward, the administration projects steady growth in highway related excise tax receipts. Net receipts in fiscal year 2003 are projected to be 6.2 percent higher than fiscal year higher than in fiscal year 2001 and 2.9 percent higher than in fiscal year 2002. Average annual growth is forecast to be more than 3 percent per year over the remainder of the budget period.

The fiscal year 2003 budget forecasts a faster long run growth in receipts than in last year's budget, however this faster rate of growth is relative to a smaller base. So the forecasted levels are lower than previously projected.

In the current budget, the administration forecasts net highway account excise tax receipts to be 28.57 billion dollars in fiscal year 2003. This concludes my oral testimony. I would be happy to answer any questions.

The CHAIRMAN. Thank you very much Dr. Lyon. Next we will move to Ms. Hecker.

[The prepared statement of Dr. Lyon appears in the appendix.]

**OPENING STATEMENT OF JAYETTA Z. HECKER, DIRECTOR,
PHYSICAL INFRASTRUCTURE ISSUES, GENERAL ACCOUNT-
ING OFFICE**

Ms. HECKER. Thank you Mr. Chairman and members of the committee. We are very happy to be here today. I have a slide show. I am actually going to cover a lot of the issues that Dr. Lyon has covered but with pictures so we will see if that helps cement and clarify that process.

Our work is based on recent efforts on The Highway Trust Fund, the RABA, and a range of related issues that are listed in our testimony.

The overview of what we are going to cover is really four areas. First is the collection and distribution of taxes as Dr. Lyon has covered.

The CHAIRMAN. Do you have copies of those slides?

Ms. HECKER. We do, we did give you copies.

The CHAIRMAN. Okay good. I've got glasses, I still have a hard time reading that.

Ms. HECKER. It is always easier having it in front of you.

The CHAIRMAN. Thank you very much.

Ms. HECKER. So we are on slide two of the overview, the four topics that I will cover. First will be the collection and distribution of highway taxes that Dr. Lyon has covered. Second is the process for calculating the RABA and our review of the reasonableness of the 2003 calculation. Third is the impact of gasohol use on the Highway Trust Fund and fourth is some proposals to provide additional revenues for the Trust Fund.

Now the first one we will go into is the collection and distribution of highway taxes. And basically I am going to show you in sequence because it's a lot of things at once. The heart of this, of course, as Dr. Lyon has said, is that the deposits are not related to the actual liabilities due. So that's what makes the whole thing complicated. And the first thing is you've got semimonthly deposits by the distributors, the oil companies or a tire manufacturer. Those deposits are not identified with a specific excise tax. It could be many, as he said, there could be up to 50. And therefore the deposits, generally are put in the General Fund to begin with and only after a complex process is a determination made of how much belongs in the Highway Trust Fund that then get invested in securities.

So this red arrow in the middle of how the monies that have been deposited get converted is really the complicated process that Dr. Lyon began to describe. And there's really two steps to it. The first is to try to do it on a timely basis, the Office of Tax Analysis (OTA) makes—our chart says monthly, Dr. Lyon said semimonthly—receipt estimates. So there is an estimating process. This isn't actual numbers, it's not tax filings. It's an estimating process to determine how much gas or other highway products was really sold in this period, in order to make some preliminary transfers. And then these other two offices, the Financial Management Service and the Bureau of Public Debt prepare and process a monthly voucher that makes an initial distribution from the General Fund into the Highway Trust Fund.

The CHAIRMAN. How often when you go back and check is that estimate fairly accurate?

Ms. HECKER. It's never been accurate.

The CHAIRMAN. It's never been accurate. You're a candid lady, I appreciate that.

Ms. HECKER. Well it varies. Sometimes it's been higher, sometimes it's been lower.

The CHAIRMAN. How often is the variance, the spread, a little uncomfortable?

Ms. HECKER. I don't have that data, we can get that for you and I'm sure Dr. Lyon has

Dr. LYON. Well the total is accurate as it's based on the total amount of excise taxes. Those have to be apportioned and we apportion it based on historical shares.

The CHAIRMAN. Alright, so maybe my question isn't terribly relevant at this point. You can be honest.

Ms. HECKER. This is a pretty convoluted process. And it is related to the way that these taxes are structured and collected. So it is relevant but it's pretty confusing and complex.

So the next step is to try to reconcile and more accurately match those initial deposits into the Highway Trust with the actual liabilities for the different types of fuels or taxes. That happens on a quarterly basis, when the fuel distributor or the one who is liable, quarterly makes tax returns. That's where they say I sold this many gallons of this, this many gallons of this, or I sold this many pounds of tires. So Treasury is for the first time matching the liability with the particular deposits that have been made. IRS then on a quarterly basis when these statements come in is going to certify—of these actual deposits and determine what correcting trans-

fers need to be made. That also results in quarterly vouchers through these other two offices that finalize the amounts that actually belongs in the Trust Fund.

We have reviewed this process for several years both on a evaluative basis about how it works, as well as on an accounting basis. We had concerns about the process. We've made recommendations to improve it's accuracy. Some improvements have been made and we actually are observing real improvements in the quality of the process and the accuracy of the data.

The underlying concern though is one that we raised doubts about and hasn't changed. And it's this basic mismatch with the initial filings with no information on where it goes—it's just for an excise tax—it could be anything. And then the resulting need for a complex process to attribute it. We said that ought to be looked at and that's an outstanding issue that I think Treasury is still looking at. But the whole basic filing process and the fact that it isn't identified is a concern.

The CHAIRMAN. And that's a concern because of the time it takes to then put Humpty-Dumpty back together again later on?

Ms. HECKER. Precisely. I think that's a very direct and simple way to put a very complex process. Now I have another slide up here. I am going apologize. I decided to add this one at the last minute. This is a quick overview of the six major excise taxes that make up the Highway Trust Fund. Because of this committee's central focus on the tax base, I decided to end up including this. And it basically shows you that the gasoline tax provides about 58 percent of the revenues, diesel taxes is about 24 percent, gasohol is about 9 percent and the three different truck related taxes, tires, sales of new trucks and taxes on heavy vehicles is about 9 percent. This is important when we get to the impact of gasohol. And as Dr. Lyon said that is the only one of the six sources of revenue that grew last year, but actually it's growth led to a reduction in the total amount of money going into the Highway Trust Fund because of the two tax provisions that you rightly pointed out.

So that's kind the quick overview of the sources. Those proportions have changed somewhat over time, but it's been relatively stable lately.

The next chart now is going to get to the 2003 RABA calculation. The key there of course is that it's the result of the TEA-21 effort to guarantee the funding level on the basis of projected receipts and have adjustments made each year, both on a look back basis, (whether the money came in was different than what was projected) and as a look ahead (whether the current projections for the future are different) than were projected in TEA-21.

So we'll first look at 2003. The look back part of the RABA calculation accounted for a negative \$3.4 billion. For the look ahead there was \$900 million less anticipated for 2003 than projected in TEA-21 and that added up to the \$4.3.

We've actually done a detailed review of the procedures that led to the negative \$3.4 billion on the look back part of the RABA calculation and found that it is reasonable and adequately documented. So we have done a pretty detailed review of that. While we think it's a pretty convoluted process, we have verified that \$3.4 billion is actually pretty accurate; for the \$900 million look ahead,

Treasury has a model that contributes to that part of the RABA number. We have looked at that model, and have no reason to question it. So basically we think the nature of the structure of the way RABA is calculated did in fact lead to this \$4.3 billion turn around.

Now the next thing I will comment on is why you get such a dramatic RABA downturn in 2003. You basically have at least three major hits that occur in 1 year when there is a dramatic downturn in the economy. You've got the difference between the first two columns in the 2003 RABA calculation. The receipts have been projected to be \$28.5 billion, that's what you wrote into TEA-21.

The CHAIRMAN. H A stands for?

Ms. HECKER. Highway Account. So \$28.5 billion had been projected to come in, only \$26.9 billion came in so that was a \$1.6 billion hit on RABA. Then the \$1.8 billion is interesting to see because that is deducted from this year's RABA amount. There was a positive RABA in 2001. So in 2000 when it was projected that receipts in 2001 would be greater than anticipated in TEA-21, the advance was made under the look ahead part of the 2001 RABA. So that \$1.8 billion had been paid out, but it then gets deducted when you do this look back projection for the 2003 RABA that in fact was an advance.

So basically we found that the 2003 RABA is reasonable and that the very structure of the RABA, the way it was designed, really leads to this triple hit where there is a dramatic downturn in the economy; it will generate these kind of severe downturns.

The next chart I have is basically there are some changes.

The CHAIRMAN. I'm sorry I ask my colleagues to jump in any time with technical questions too. Why, back on the last chart I never see 2002 anywhere?

Ms. HECKER. Well that's the current year. So you're not getting the corrections and the look back for the current year that's in process. So you go back to an actual year—remember the certification—the data is now certified what actually came in—so the current year is in process and that's not part of the look back. You go back 2 years.

The CHAIRMAN. Thank you.

Ms. HECKER. Okay if the Congress wants to keep a RABA there are different formulas it could consider. We have developed three here. Basically two of them would still have had positive pay outs in 2000, 2001, 2002. But both would have gone negative in 2003.

There is one, (the black line) that could be done by distributing the RABA adjustment over 2 years. What's interesting about that one, while we are not recommending it, it actually had a higher positive net adjustment for the whole period and it never went negative. So it would be a formula that would soften out considerably those swings and it actually (at least in the circumstance of the past few years) would have not resulted in a negative RABA this year. That's just for your consideration. We are happy to try to do some more work for you about what you would like to do with the RABA.

The next issue, you understood this very well, so this is a simple primer, I will try to go through this one quickly. This is the third

topic on how gasohol impacts the account revenue. There's basically two ways that it affects it.

First you see there is the difference in price. Basically that difference is due to a partial tax exemption. There is the 5.3 cents tax difference per gallon between gasohol and gasoline. As Dr. Lyon said you can see here the difference of what goes into the highway account from gasohol, 7.6 cents for every gallon sold, whereas for every gallon of gasoline you've got over 15 cents going in. So you've got even more than the 5.3 difference because of the 2.5 cents that's transferred into the General Fund.

So it's basically again a double hit for the tax provision. As you rightly said, there was a public policy purpose to this. We focused on the impact on the Highway Trust Fund, not whether there should be promotion of alternative fuels and whether there is a national policy purpose. But our analysis focuses on the impact on the Trust Fund.

Next we've taken Treasury's data and showed it on an annual basis. Looking back, the partial tax exemption for gasohol cost the Highway Trust Fund nearly \$4 billion in the past 4 years. The General Fund transfer cost about \$2 billion for a total of 6 billion.

Projecting forward, the partial tax exemption will result in lost revenues of nearly \$14 billion over the next 11 years. The General Fund transfer would account for up to about \$7 billion for a total of nearly \$21 billion over the next 11 years. So it's a very substantial amount. And you I think understand those two pieces and how they both play out.

And this is why that increase in gasohol, the only source of revenue that increased in 2001, actually led to a net reduction of the revenue that went into the Trust Fund, because it was displacing gasoline which would have generated much more funds for the Trust Fund.

Clearly then we are looking at some challenges. While we do show some continued projections of the Highway Trust Fund revenues, they are no where near keeping pace with the demands that are projected for major highway improvements.

The ideas that have been put out, clearly you brought up the one about altering the tax treatment of gasohol. Basically our analysis shows that both the 2.5 cent and the 5.3 cent per gallon changes would generate about \$1.8 billion extra for the Trust Fund each year.

The other one you mentioned would be to allow the interest on the Trust Fund to be accrued to the Highway Trust Fund. That would, based on our analysis, generate about \$1 billion a year.

Other ideas are out there. The increased use of tolls—there is some very interesting and promising research—on not turning current roads into tolls roads, but the few places where you can really build some new roads, have those be "HOT lanes," they call them. High occupancy toll lanes, and it's a very promising idea that there is some research that this is a way that you could both generate the funds and allocate what is clearly very congested, scarce capacity for expanding these roads.

There are other innovative finance tools that more evaluation needs to be done on what promise they have. There is some concern about those because they are not really any new money. Most of

these would borrow against the future stream of income and are not really new money. Mortgages are good, we all buy houses but it's not really new money so it's got to be looked at with an awareness of what it really does.

And finally, one of the most significant ones might be to modify highway user taxes. It's never a very attractive option; however there is some equity basis for this. For example the taxes on heavy trucks are very well documented to not cover their damage to the road. The most recent study says that, they pay about half the damage. Cars pay the full amount. Light trucks actually pay 1½ times the cost. The alignment of the tax base really is not capturing the use and the damage by the different classes of user, so there's some opportunity there to generate better equity in the application of those taxes and at the same time very reasonably be able to generate more income.

These of course, are policy decisions of the Congress. There isn't one right answer to these. This is the challenge that as my summary says is really for the Congress. Looking at the sustainability of the Highway Trust Fund over the long term. That's an interesting one to look at, both the needs side and the revenue side and how you get that matched. We are talking mostly about revenue here, but a lot of that is the TEA-21 process of clarifying goals the programs, the Federal role and the leveraging of Federal dollars.

And these are basically the significant challenges that face the Congress in the upcoming re-authorization.

The CHAIRMAN. That was very helpful, thank you very, very much Ms. Hecker.

Ms. HECKER. Thank you Mr. Chairman.

The CHAIRMAN. While I'm at it I want to thank all three of you. You perform a great public service all of you here. We appreciate it in the committee and I know the public does and I know a lot of people will watch it on C-Span and think boy that's very interesting, so thank you very much.

Ms. HECKER. Thank you Mr. Chairman.

[The prepared statement of Ms. Hecker appears in the appendix.]

The CHAIRMAN. The same goes for you Mr. Cawley. I like your title, Unit Chief, National and Physical Resources Cost Estimate Unit in CBO. You're the head guy in that unit and we all want to hear what you have to say.

OPENING STATEMENT OF KIM CAWLEY, UNIT CHIEF, NATIONAL AND PHYSICAL RESOURCES COST ESTIMATES UNIT, CONGRESSIONAL BUDGET OFFICE, WASHINGTON, DC

Mr. CAWLEY. Thank you, Mr. Chairman, and Members of the Committee. I am pleased to be here this morning to discuss the status of the Highway Trust Fund. I'll explain how the Congressional Budget Office (CBO) develops its baseline estimates and review spending and receipt alternatives requested by Committee staff. I have also distributed copies of a few graphs that we will be looking at this morning.

The status of the Highway Trust Fund is assessed by asking two questions. First, will receipts to the fund be sufficient to cover

spending? And second, will the trust fund pass the so-called Byrd test, which was established early in the fund's history?

The balance of the Highway Trust Fund at the end of last year was about \$28 billion. That amount is the difference between receipts and outlays over the life of the fund. The balance shows how much the fund has available to meet its obligations, but that amount is not necessarily available for new spending. Existing obligations are greater than the fund's balances, and many of those obligations must be met using future receipts.

Determining whether or not the fund will pass the Byrd test is a bit more complicated than checking the fund's balances.

The CHAIRMAN. Could you explain the Byrd test please?

Mr. CAWLEY. I am going to try. Accounts in the trust fund can be said to pass the Byrd test if the amount of unspent budget authority in a given year exceeds the balance of the account by no more than the fund's projected receipts for the next 2 years. If an account were to fail the Byrd test, automatic cuts would be made to contract authority.

Today, the Byrd test does not really effectively measure the status of the trust fund because spending is controlled mainly by obligation limitations set in appropriation acts and not by the budget authority set in authorization acts. For example, the trust fund does not fail the Byrd test in CBO's baseline even though the fund's balances would be depleted over the baseline projection period [2003 through 2012]. The trust fund also does not fail the Byrd test in any of the alternatives that I will be talking about today.

The first chart we have today illustrates CBO's baseline for the Highway Trust Fund over the next 10 years [see Figure 1 in the statement]. We expect receipts over this period, mostly from the gasoline tax, to average about \$39 billion a year. In general, we estimate receipts from motor fuel taxes by projecting growth in the economy and its effect on fuel use.

I should point out an important revenue baseline assumption here. Under the Balanced Budget and Emergency Deficit Control Act, CBO must assume that the tax receipts deposited into a trust fund will continue to be collected even if the taxes are scheduled to expire. For example, most gasoline taxes are scheduled to expire at the end of fiscal year 2005. In our baseline, however, we continue projecting receipts from the gasoline taxes over the 10-year period.

Estimated spending from the Highway Trust Fund averages about \$40 billion a year over our baseline period. To make that projection, CBO began with the budget authority and obligation limitations enacted in the 2002 appropriation acts and inflated those figures for each of the following years. That method of projecting spending is required by the Deficit Control Act and is consistent with how CBO estimates spending for other discretionary programs. However, using this rule does not allow the baseline to reflect the RABA (revenue-aligned budget authority) adjustment for 2003 or the expiration of the Transportation Act for the 21st Century (TEA-21).

Under CBO's baseline assumptions, we projected that the balance in the highway account would be depleted in 2006 because over the next 10 years, outlays will exceed receipts by \$4 billion a

year. For the mass transit account, the story is similar: the balances in the account will be depleted by 2009 because over the next 10 years, outlays will exceed receipts by about \$600 million a year.

The CHAIRMAN. Now is it true that transit doesn't get RABA treatment as does the Highway Trust Fund?

Mr. CAWLEY. That's correct.

Next, I am going to discuss the balances of the Highway Trust Fund under three alternative spending plans—that is, obligation limitations for the highway program—that were requested by Committee staff.

The first alternative would set the obligation limitation for the Federal-Aid Highway program at \$28 billion in 2003 and inflate it for the rest of the baseline period [see Figure 2 in the prepared statement]. This obligation limitation would equal the amount authorized under TEA-21 without the RABA adjustment. Under this alternative, balances in the highway account would drop to \$11 billion in 2005 and gradually increase in the out-years of the period.

The second alternative that we looked at would set the Federal-Aid obligation limitation at \$29 billion for 2003, the amount assumed in the budget resolution recently reported by the Senate Budget Committee. Under this alternative, balances would drop to about \$7 billion by 2007 and then gradually increase over the following years of the period.

The CHAIRMAN. Does that include RABA?

Mr. CAWLEY. For 2003, it does not.

The CHAIRMAN. For alternative two?

Mr. CAWLEY. No—just \$29 billion.

The CHAIRMAN. It doesn't assume the RABA provision in the current program?

Mr. CAWLEY. Right.

The CHAIRMAN. Thank you.

Mr. CAWLEY. The third alternative would set the Federal-Aid obligation limitation at \$30.1 billion in 2003. Under this alternative, the balances in the highway account would fall below \$1 billion but would not hit zero during CBO's baseline period. And that \$30.1 billion approximates the highest obligation limitation that could be inflated in the out-years without depleting the account's balances over the baseline period.

But a spending option that draws down the trust fund balance close to zero runs a significant risk of there not being enough balances to meet the fund's obligations. Actual spending and receipts are likely to deviate from projections in one direction or another because the rate of spending may vary, the economy may rise or fall unexpectedly, or the Congress may appropriate additional resources from the trust fund to meet unanticipated needs.

The last graph that we have today presents the impact of some alternatives, requested by Committee staff, that would increase receipts to the trust fund [see Figure 3 and 4 in the statement].

The tax on gasohol is currently 13.1 cents per gallon, but receipts equaling 2½ cents of that amount are deposited in the general fund, not in the Highway Trust Fund. Under this alternative, receipts from the 2½ cents per gallon of gasohol tax would be transferred from the general fund to the Highway Trust Fund starting in 2004. This alternative would not change the total amount of re-

ceipts to the Federal Government, only where the receipts were recorded. Using CBO's estimates under this alternative, receipts to the highway account would increase by about \$600 million a year and by a total of about \$5 billion over the baseline period.

With those additional receipts, the obligation limitation for the Federal-Aid program could be set at \$30.7 billion in 2003, and that amount would not deplete the balances in the account over the next 10 years. That obligation limitation is about \$600 million higher than what could be set using CBO's baseline projections of receipts.

The second alternative would increase highway account receipts as though the gasohol tax were 5.3 cents higher, or equal to the gasoline tax. Under this alternative, we estimate that receipts to the highway account would increase by about \$1.3 billion a year, for a total of nearly \$12 billion over the baseline period.

With those additional receipts, the obligation limitation for the Federal-Aid program could be set at \$31.4 billion beginning in 2004 without depleting the account's balances over the baseline period. That limitation is about \$1.3 billion higher than the limitation under our baseline projections.

One last alternative I'll discuss is the impact on the Highway Trust Fund of a combination of alternatives: first, increasing receipts to the fund by raising the gasohol tax to equal the gasoline tax and transferring all of the gasohol receipts to the highway account; and second, allowing the trust fund to accrue interest on its balances. Until 1999, the Highway Trust Fund accrued interest on its balances, but TEA-21 ended the authority to credit the fund with interest. Securities credited to a trust fund do not bring the Federal Government additional receipts; they are an intragovernmental transfer.

Making the gasohol tax equal to the tax on gasoline and depositing all gasohol receipts into the highway account would increase receipts to the highway account by about \$17 billion. Crediting the highway account with interest would add almost \$2 billion more over the next 10 years. Using CBO's estimates of the additional receipts, the obligation limitation for the Federal-Aid program could be set at \$32.1 billion in 2003 and continue to be inflated over the next 10 years without depleting the balances within the account. That obligation limitation is about \$2 billion higher than what could be set using CBO's baseline projections of receipts.

In addition, authorizing the mass transit account to accrue interest would increase the accounts' receipts by almost \$1 billion over the next 10 years. Under that alternative, balances for the mass transit account would not be depleted as they are in the CBO baseline. But the balances would fall well below \$1 billion for several years.

That concludes my statement. Unfortunately, my prepared statement today contains some misprinted figures, and I will need to provide the Committee with a corrected version.

[The prepared statement of Mr. Cawley appears in the appendix.]

The Chairman. Sure, thank you very much. Thank you all very, very much. I will just take a few minutes here because I know Senator Jeffords has been waiting very, very patiently.

Is there any difference in estimates between GAO and CBO here on what the 2½ cent transfer would be or the 5.4 percent transfer, using same figures, same estimates, same assumptions, time spans, current versus constant dollars? I'm just curious whether there is a difference there that needs to be reconciled.

Ms. HECKER. We haven't compared methodologies. I just listened to the numbers and they are very similar to our so maybe—

Mr. CAWLEY. It's possible that we covered different years; I'm not sure. Our alternatives started in 2004.

The CHAIRMAN. It would be helpful if you could reconcile methodologies to be sure we are comparing apples to apples here.

Ms. HECKER. That involves Treasury too because it's Treasury's projections that we built our data on and we broke it out by each source that you had projected too. So really you had to look at each of the sources because the tax rates are different.

The CHAIRMAN. I only ask because my staff indicates that there's about a \$4 billion difference in the total. If you compare the CBO and GAO estimates with respect to both the 2½ cent transfer and the 5.3 cent transfer it's \$17 billion for CBO, \$21 billion for GAO, that's a \$4 billion difference. One is for 10 years and one is for 11.

Anyway the point is if you could—

Ms. HECKER. After consulting with CBO, we believe that the difference of about \$4 billion between CBO's and GAO's estimates of the impact of future gasohol sales on the Highway Trust Fund is attributable to 3 reasons. First, CBO's calculation includes a projection for each of the next 10 years, while ours (GAO's) includes 11 years. Second, CBO's projections are in current dollars while we use constant dollars. Finally, to develop our projection of the expected impact of future gasohol sales on the Highway Trust Fund we used Treasury's estimates of future gasohol sales, which are slightly higher than CBO's estimates.

The CHAIRMAN. One point that struck me quite vividly. And that is, as you well know in the Energy Bill that is going through Congress, there are lots of tax incentives for hybrid vehicles, for alternative fuel vehicles. Some think that perhaps this country in the not too distant future is going to perhaps have fuel cell vehicles. They are not going to be paying a lot of gasoline tax into the Highway Trust Fund. Your thought is—and any suggestions as we transition into different modes of surface transportation and different energy production and we transition revenues into the Highway Trust Fund—any thoughts?

Ms. HECKER. Those are very significant issues and I think in some sense you are really ahead of the curve trying to think about this for this re-authorization. You could probably make it through the gasohol projections—although the new energy legislation—we don't have the estimates there and that clearly will alter the picture.

Over the long run the vehicles we use, the emissions they have, are not sustainable and something really will need to be done. So the current concept of the financing of fuels as cars get more fuel efficient and alternative fuels are developed, those cars are still on the road just as you pointed out. There clearly is a need in the long run to start thinking about differences. There is some very interesting research in intelligent systems and new ways to think about

taxation that go to the issue of the equity that I talked about. That would better capture both the weight and the distance traveled. It's perhaps not ready for this re-authorization but some more experimentation and development of basically new ways of taxing and raising the revenues that keep that basic user fee concept which is really important, of tying the taxation to the use and the damage—and that's already been eroded—clearly that might be an area that the committee would want to explore.

The CHAIRMAN. Well it definitely is and at some point I will make a formal request to GAO to study this—the viability of the Trust Fund and particularly with respect to hybrids and alternative fuels and so forth. Because I just think—even though you could well be correct that, that will be significant next re-authorization, not the upcoming—it still is important for us to start thinking about it. Getting ahead of the curve as best we can so that we are minimizing ad hoc, immediate catch up kinds of solutions that aren't thought through as well as they possibly could. That I think is key. I've taken a lot of time already, I would like to turn it over to my good friend Jim Jeffords.

Senator JEFFORDS. I have a related question here. The staff of the Joint Committee on Taxation provided a paper entitled, Overview of Highway Trust Fund Excise Taxes and Related Internal Revenue Code Expenditures Provisions, as background for today's hearing. In that paper on pages 10 and 11, there is a discussion entitled "Raising Revenues", which addresses the matter of fees versus taxes. Much of the policy dialogue surrounding our surface transportation programs is premised on the notion that the Highway Trust Fund is comprised of fees that are paid into the fund by users. Is that an accurate premise? Are we dealing here with user fees, or are we dealing with taxes? Anyone have thoughts?

Ms. HECKER. I haven't read the study, but I am happy to comment. The difference between fees and taxes and user fees is a very significant difference. And that is the point I was trying to make. That I think the concept has been there, but it has been eroded and it isn't well enough a line to really call most of these taxes user fees. That you really—a user fee really relates to the cost imposed by individual users. So we would be happy to take a look at that study and comment on it. That's a very important distinction and one that should be noted.

Senator JEFFORDS. I would appreciate the comments of Mr. Cawley.

Mr. CAWLEY. As the study points out here, there is often disagreement in discussions about what constitutes a user fee and what constitutes a tax. Not every case has been entirely clear. Certainly, the current taxes imposed on fuels are taxes. I haven't read their work here and I'm not sure of the importance of the distinction that the JCT is trying to make.

Senator JEFFORDS. We would appreciate if you would take some time and send us a written answer on that, I would appreciate it.

Mr. CAWLEY. Okay.

The CHAIRMAN. If I might add, what is the legal distinction between taxes and fees? Have the courts addressed this? I am sure they have, anyone know?

Mr. CAWLEY. We are all economists here. I think in the budget world, the idea is that a fee is tied to the receipt of a benefit in exchange for payment of the fee in a very direct way.

The CHAIRMAN. Unlike highway taxes? I'm being facetious here.

Mr. CAWLEY. When we talk about taxes, we are usually talking about the government's sovereign power to tax. It may not be related to a direct benefit to an individual.

The CHAIRMAN. A fee may not or a tax may not?

Mr. CAWLEY. A tax.

The CHAIRMAN. That's clearly a very valid point that Senator Jeffords has raised.

Dr. Lyon, you talked earlier about some abused of collections and reporting outside sort of the distribution network, as I understood you. And you had some pretty innovative thoughts that Treasury is thinking of to track some of this down. From my notes here new techniques I didn't write new techniques down but you are talking about better tax compliance needed outside the main distribution system and certain dollars lost, but you are coming up with some new techniques to try to minimize that. I forgot what they were. Would you explain that please?

Dr. LYON. Some of those are new technology, and again new technology may help address how we can collect taxes on the regular base. One I mentioned is fuel fingerprinting which helps attempt to analyze the physical contents of the fuel at a retail station and compare it to the nature of the fuel of the supplier that typically services that service station to make sure that molecularly it is the same fuel. It is has been adulterated that could be detected and at least trigger an investigation.

The CHAIRMAN. How much is unreported, do you think? Roughly what percent, that is due as unreported?

Dr. LYON. I don't know.

The CHAIRMAN. Do you have a gut guess?

Dr. LYON. No I don't.

The CHAIRMAN. I am sure somebody does in Treasury. At least I hope somebody in Treasury does. Could you get that to us. And other compliance problems that Treasury is having with respect to fuel taxes and give us some recommendations.

Dr. LYON. Sure.

The CHAIRMAN. I think Ms. Hecker, you were talking about some recommendations you will be making soon with respect to RABA and you have your different lines in your chart, what is a tool averaging it out. But you said you are not recommending that. I there any reason why you are not recommending that?

Ms. HECKER. Because it's your discretion. There isn't really one right answer. I mean we are happy to do whatever additional analysis might be useful but I don't think there's really one right answer. It's a policy call on the part of Congress about tying the funds and what your intent is. I think clearly the concern was with the major negative this year there was concern that you didn't want to have a negative. And what we tried to do was identify some alternative that might smooth out a downturn. And clearly we're reminded these days that there are economic downturns and that it in fact caused a very significant shift. So it's really a policy call on the part of Congress.

The CHAIRMAN. Right and frankly that black line you had is quite attractive to me the averaging distributing adjustment over 2 years.

Ms. HECKER. Right.

The CHAIRMAN. And it's what I would like to include in the Highway Bill. I think it makes good sense. It does have the effect, as you say of flattening out the curve a bit to minimize the volatility that otherwise occurs under current law.

Ms. HECKER. Yes, however the interesting thing about that is that there would have been a net increase in the pay out from that one.

The CHAIRMAN. Now why is that?

Ms. HECKER. I'm sure it's just quantitative, but basically averaging out you wouldn't have had the negative this year. You wouldn't have had the positive advance—it would be more reliably related to what actually comes in. We've got this lag in data so it's more reliable.

The CHAIRMAN. I know what you are saying—I can't articulate it either but I think you are on to something.

Would either of you or Dr. Lyon explain—let's say January 1 is the date that let's say—somebody drives up to a gasoline pump and fills his tank up full of gas. Maybe it's truck or diesel fuel, I don't know if there is or isn't—looking at this chart that you gave to us, Ms. Hecker, which is a very interesting one about the flow of all this and Mr. Lyon you described it as well. By what date is either the monthly or the quarterly voucher made for initial distribution or for final adjustment, either one? How many days does it take to get from January 1 to that voucher?

Dr. LYON. My understanding is that the semi monthly deposit would be made mid January. Initially that deposit would go into the General Fund. Within several days from the semi monthly deposit I think we would then make the transfer to the Highway Trust Fund based on an estimate of what that excise tax payment reflects. Again, the depositor would be paying a number of different excise taxes at the same time.

The CHAIRMAN. Well let's say we are in the middle of a re-authorization period, middle of re-authorization of the Highway Bill. And we are at January 1 in the middle and that's when the guy New Year's Eve and that's when the guy drives up to the pump to fill it up, by what date can whoever makes this, either a state have the obligation or know what the obligation is. I'm not quite sure what I'm asking here but I'm just trying to get a sense of how this works.

Ms. HECKER. The allocation to the State is another matter entirely. We haven't gone into that. We've done some work on that in the past. That is very complicated because it's a formula that tries to estimate how much gas was actually purchased in that State and none of it is reported like that. So there is another whole estimating process to figure out how much actually was purchased in that State. Because all of this reporting has nothing to do with where the gas was bought. It was where it was sold to a distributor or transferred into a tanker truck. So you've opened up another whole can of worms and you will have to have another whole hearing on that one. That is a very complicated process.

The CHAIRMAN. You seem to know something about it.

Ms. HECKER. Well, I have an answer from a financial person who actually has tracked this and done interviews and he said the short answer to your question of the actual certification into the Trust Fund not by State, is September 30th.

The CHAIRMAN. September 30th, it takes about 9 months?

Ms. HECKER. A full 9 months.

The CHAIRMAN. Okay now let's just go to the next question. We have the certification, roughly how long after the certification—I'm assuming—is my assumption correct that it is a sequential process?

Ms. HECKER. I think some of it is parallel. There is a process going on that is estimating how much was purchased in each State and it is a complex process that has very little to do with this. Because this is not the data. This is not going to tell you how many of them went to Montana and how many went to Chicago. It's the filling of the tanker truck. I did not prepare on that. We have done some work and I would be happy to back up and talk to you.

The CHAIRMAN. Well we are going to have to deal with that at some point either formally or informally. The Highway Bill has to be re-authorized, it would be a good idea as possible to help with the mechanics here so we know what we are doing.

Ms. HECKER. If I could add about the State issue. There is a very complicated relationship here because all of the increased use of gasohol really penalizes the States that are using it because that formula is based on how much gasoline is sold.

The CHAIRMAN. Correct.

Ms. HECKER. And so the more you have the increased use of gasohol and so again you have another area where there is probably some increased urgency to think through how that allocation to the State is made particularly if the Energy Bill passes and those extra incentives are there, the States that are making extra use of gasohol will be penalized in the allocation that they get.

The CHAIRMAN. I would like to frankly, to get into some preliminary thought on that because if the Energy Bill does pass we are certainly going to have to address that question very thoroughly.

Senator JEFFORDS. I would like to join in that request.

The CHAIRMAN. Yes, I think it is very important. I have no more questions I do have a lot more questions frankly. This has opened up more questions than it answered but we will have to deal with those later.

Senator JEFFORDS. I have no further questions at this time. I think we all are going to have to re-look at things. There are so many changes that are going on with different results. This is going to be a very interesting time to figure out how we come to better systems. Thank you.

The CHAIRMAN. It is just clear that there are real trends which could reduce the funds. Gasohol is one new fuels is another. As our country changes it's transportation modes, this is not automatic just because the economy is going up and people are driving cars perhaps a little more, that there is more dollars in the highway Trust Fund. And add to that too is the tremendous needs of this country, tremendous opportunities of transportation related infrastructure development. It's kind of exciting actually. There is a lot to look forward to. This has been a good start. We will have many

other steps along the road, but thank you very much all of you.
Hearing is recessed.
[Whereupon at 10:54 a.m. the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

CBO TESTIMONY

Statement of
Kim P. Cawley
Chief
Natural and Physical Resources Cost Estimates Unit

Status of the Highway Trust Fund

before the
Committee on Finance
United States Senate

May 9, 2002
(Revised)

*This statement is embargoed until 9:30 a.m. (EDT),
Thursday, May 9, 2002. The contents may not be
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Mr. Chairman and Members of the Committee, I am pleased to appear before you this morning to discuss the status of the Highway Trust Fund and to explain how the Congressional Budget Office (CBO) develops its baseline estimates of the fund's receipts and outlays. In addition, as requested by Committee staff, I will discuss how certain alternative approaches to spending and receipts would affect trust fund balances.

WHAT IS THE HIGHWAY TRUST FUND?

The Highway Trust Fund is an accounting mechanism in the federal budget that records receipts from certain fuel and excise taxes, as well as spending on designated highway and mass transit programs. The fund comprises two separate accounts, one for highways and one for mass transit (see Table 1). The Federal-Aid Highway program is by far the fund's largest component, accounting for about 80 percent of its outlays in 2001. (All years in this statement are fiscal years.)

TABLE 1. MAJOR COMPONENTS OF THE HIGHWAY TRUST FUND, FISCAL YEAR 2001
(In billions of dollars)

	Receipts ^a	Budget Authority and Obligation Limitations ^b	Outlays
Highway Account			
Federal-Aid Highway program	n.a.	31.1	28.5
Motor carrier safety	n.a.	0.3	0.2
Highway traffic safety	n.a.	0.3	0.3
Other	n.a.	1.5	0.1
Subtotal	26.9	33.2	29.1
Mass Transit Account			
Discretionary grants	n.a.	0	0.7
Trust fund share of transit expenses	n.a.	5.0	5.0
Subtotal	4.6	5.0	5.7
Total, Highway Trust Fund	31.5	38.1	34.8

SOURCE: Congressional Budget Office.

NOTES: Numbers may not add up to totals because of rounding.

n.a. = not applicable.

a. Receipts are deposited in the highway and mass transit accounts but are not earmarked for specific components.

b. Obligation limitations enacted in appropriation acts limit the amount of budget authority available to most Highway Trust Fund programs. The amounts in the column are the sum of obligation limitations and budget authority that is not subject to any such limitation.

FUNDING OF HIGHWAY AND MASS TRANSIT PROGRAMS

Spending from the Highway Trust Fund is not automatically triggered by deposits of receipts. Authorization acts provide budget authority for highway and mass transit spending, mostly in the form of contract authority (the authority to incur obligations in advance of appropriations). For mass transit programs, funding is also provided by appropriations from the general fund of the Treasury. Annual spending from the Highway Trust Fund is largely controlled by limits on annual obligations, which are set in appropriation acts.

The most recent authorization law for the trust fund, the Transportation Equity Act for the 21st Century (TEA-21), was enacted in 1998 and is due to expire at the end of 2003. TEA-21 provided specific amounts of annual contract authority for 1998 through 2003 and authorized appropriations for mass transit programs and for certain programs that are not funded through contract authority. In addition, TEA-21 included a new funding mechanism called revenue-aligned budget authority (RABA). RABA compares current estimates of highway account receipts with the amounts specified in TEA-21. The RABA calculation combines “looking back” at the prior fiscal year and “looking ahead” at the coming budget year. On the basis of that comparison, RABA adjusts both contract authority for the Federal-Aid Highway program and the budget caps for the highway category of discretionary spending.

The RABA mechanism was designed to strengthen the relationship between the account’s receipts and its outlays. However, each year, appropriation acts include an obligation limitation that may or may not contain a RABA adjustment. Thus far, appropriation acts for 2000, 2001, and 2002 have incorporated positive RABA adjustments, adding about \$9 billion to the obligation limits specified in TEA-21. Primarily because of a recession-induced drop in revenues in 2001, the Administration has calculated a negative RABA adjustment for 2003 of about \$4.4 billion. (The levels of receipts, budget authority, RABA adjustments, obligation limitations, and outlays for the Highway Trust Fund since enactment of TEA-21 are summarized in Table 2.) Over the first five years of TEA-21, the trust fund’s receipts have grown by about 13 percent, and outlays have climbed by more than 50 percent.

TABLE 2. THE HISTORY OF THE HIGHWAY TRUST FUND UNDER THE TRANSPORTATION EQUITY ACT FOR THE 21ST CENTURY (By fiscal year, in billions of dollars)

	1998	1999	2000	2001	2002	2003
Receipts	28.6 ^a	39.3 ^a	35.0	31.5	32.3 ^b	33.4 ^b
Budget Authority	29.4	33.6	35.1	41.3	41.2	37.7 ^b
RABA Adjustments to Contract Authority	n.a.	n.a.	1.5	3.1	4.5	0 ^c
Enacted Obligation Limitations	24.0	30.1	32.7	35.2	37.8	n.a.
Outlays	24.5	28.9	32.8	34.8	37.5 ^b	40.1 ^b
End-of-Year Balance	18.6	29.0	31.1	27.7	22.5 ^b	15.7 ^b

SOURCE: Congressional Budget Office.

NOTE: RABA = revenue-aligned budget authority; n.a. = not applicable.

- Receipts in 1998 and 1999 were affected by the Taxpayer Relief Act of 1997. That legislation allowed taxpayers to pay the highway excise taxes normally due in the last two months of 1998 during the first week of 1999, shifting about \$6 billion in receipts.
- CBO estimate. For 2003, the estimated outlays are CBO's baseline projection, assuming total obligation limitations of \$38.5 billion.
- Although the -\$4.4 billion RABA adjustment to obligations is scheduled to occur in 2003, the adjustment to contract authority is scheduled for 2004.

STATUS OF THE HIGHWAY TRUST FUND

The status of the Highway Trust Fund is generally assessed by asking two questions. First, will the fund's receipts be sufficient to cover its spending? Second, will the trust fund accounts pass the so-called Byrd test?

Trust Fund Balances

The balances of the Highway Trust Fund represent the cumulative difference between receipts and outlays over the life of the fund and indicate how much the fund has available, at any particular time, to meet its current and future obligations. Existing obligations of programs paid out of the highway account far exceed the amounts now in the account. At the end of 2001, the highway account's balance was \$20.4 billion, but the outstanding obligations of highway programs totaled \$40 billion. That discrepancy is possible because most of those obligations involve capital projects, on which money is spent over a number of years. In other words, some of

the highway programs' existing obligations will be met by using future tax receipts. In comparison, the mass transit account had a balance of \$7.4 billion at the end of 2001 and outstanding obligations of \$1.2 billion.

The Byrd Test

The Highway Revenue Act of 1956 created the Highway Trust Fund, and it established a test that was designed to ensure that the fund's future resources would be sufficient to cover its spending authority. The test is still called the Byrd test after Senator Harry Byrd of Virginia, a member of the Senate Finance Committee in 1956.

Today, the Byrd test is applied separately to the trust fund's highway and mass transit accounts. An account is said to pass the test if its unspent budget authority at the end of the fiscal year exceeds its balance by no more than its projected receipts for the next two years. For example, to pass the Byrd test at the end of this fiscal year, the highway account must show estimated receipts for 2003 and 2004 combined that are greater than the total amount of unspent budget authority above the 2002 balance.

If the highway or mass transit account fails the Byrd test, the level of the account's contract authority is automatically reduced. The trust fund has failed the test only once, resulting in cuts to the level of contract authority for 1961. (Those cuts occurred before TEA-21 created separate highway and transit accounts.)

Currently, however, the test does not effectively measure whether the fund has adequate resources to cover present or future commitments. That is because spending is now controlled mainly by obligation limitations rather than by budget authority. For that reason, even if projections indicated no failure of the Byrd test, they might still indicate that the fund's balances would be depleted. That situation occurs under CBO's baseline, as discussed later.

CBO'S BASELINE PROJECTIONS OF THE HIGHWAY TRUST FUND

CBO estimates the Highway Trust Fund's balances and the results of the Byrd test by projecting the fund's future receipts and outlays over a 10-year period. Receipts and outlays are estimated independently of each other because of their different bases—receipts depend on the collection of various taxes, and outlays depend largely on the obligation limitations in appropriation acts.

Receipts

The Highway Trust Fund's receipts come from excise taxes on various motor fuels; on the sale of tires, trucks, and trailers; and on heavy-vehicle use (see Table 3). Each year, about 60 percent of the fund's receipts come from the tax on gasoline alone. As a general rule, CBO's baseline projections of tax receipts for 2003 through 2012 (the current projection period) incorporate the assumption that current tax laws remain in place and that scheduled changes and expirations occur on time. The only exception to that rule is the treatment of excise taxes dedicated to trust funds, including the Highway Trust Fund. The Balanced Budget and Emergency Deficit Control Act requires CBO to assume that the federal government will continue to collect tax receipts that are earmarked for a trust fund even if those taxes are scheduled to expire. For example, gasoline taxes are due to expire on September 30, 2005, but CBO's baseline includes receipts from the gasoline tax throughout the 10-year baseline projection period.

TABLE 3. HIGHWAY TRUST FUND RECEIPTS FOR FISCAL YEAR 2001 (In billions of dollars)

	Highway Account	Mass Transit Account	Total Trust Fund
Gross Receipts			
Gasoline	16.9	3.1	20.1
Gasohol	1.5	0.6	2.1
Diesel and special motor fuels	7.2	1.0	8.1
Tires	0.3	0	0.3
Trucks and trailers	1.5	0	1.5
Heavy-vehicle use	0.6	0	0.6
Other	*	*	*
Subtotal	28.0	4.7	32.7
Refunds and Tax Credits	-0.9	-0.1	-1.0
Transfers to Other Trust Funds	-0.2	*	-0.2
Net Receipts	26.9	4.6	31.5

SOURCE: Congressional Budget Office.

NOTES: * = less than \$50 million.

Numbers may not add up to totals because of rounding.

In forecasting Highway Trust Fund receipts, CBO's economic models must consider numerous factors. For example, estimates of gasoline consumption depend on estimates of economic growth, relative fuel prices, and the average fuel efficiency of gasoline-powered vehicles. Projections of receipts from the gasoline tax equal gasoline consumption multiplied by the federal tax rate (18.4 cents per gallon under current law). For 2001, the Highway Trust Fund received \$20.1 billion from the gasoline tax and a net total of \$31.5 billion in receipts.

Spending

In its baseline projections of outlays for the trust fund, CBO assumes that policymakers will continue to control spending through obligation limitations set in annual appropriation acts. (The obligation limitation for the Federal-Aid Highway program controls more than 70 percent of the outlays from the Highway Trust Fund.) For the current baseline, CBO began with the budget authority and obligation limits enacted in Public Law 107-87, the 2002 appropriation act for the Department of Transportation and related agencies, and then inflated those figures for each of the following years of the baseline period. Using that method, CBO projects obligation limitations well beyond 2003, the year that TEA-21 expires.

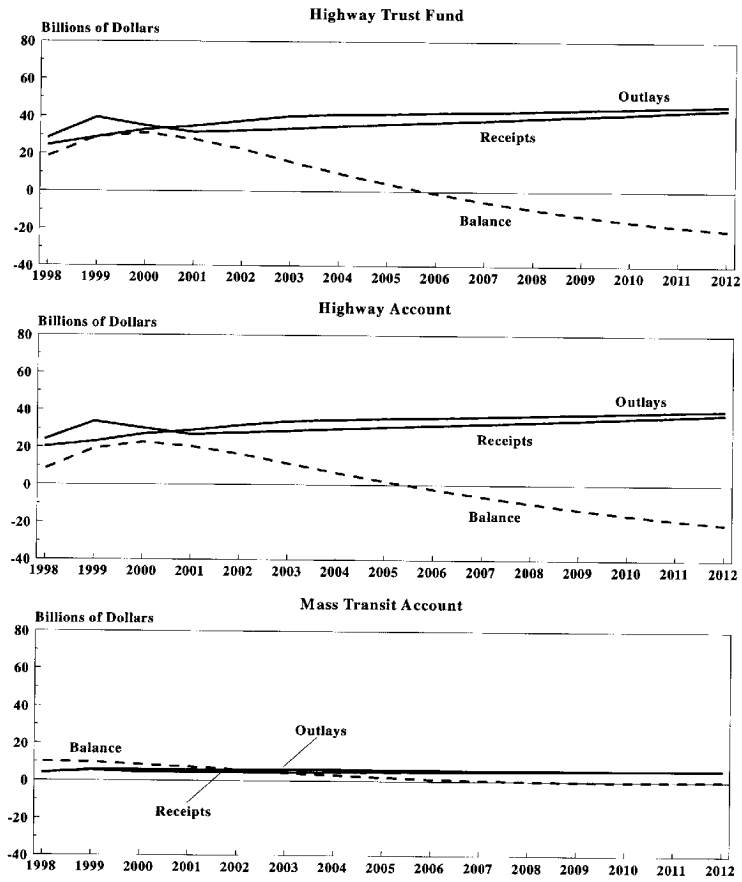
CBO bases its estimates of the trust fund's outlays on historical spending patterns. For example, the Federal-Aid Highway program expends about 27 percent of budgetary resources in the year they are provided and the rest over the following several years.

The Deficit Control Act prescribes the method that CBO uses to project baseline resources and spending for the highway program. That same method is used to estimate outlays for other discretionary programs, which also receive spending authority from appropriation acts. Any change to the way CBO treats transportation spending in its baseline would require amending that law.

BALANCES IN THE TRUST FUND ACCOUNTS UNDER CBO'S BASELINE

Under its current baseline, CBO projects that the highway account will be depleted in 2006 and that the balance in the mass transit account will fall to zero in 2009 (see Figure 1). However, CBO estimates that the highway and mass transit accounts will not fail the Byrd test in any year of the current projection period (through 2012).

FIGURE 1. STATUS OF THE HIGHWAY TRUST FUND UNDER CBO'S BASELINE



SOURCE: Congressional Budget Office.

The Highway Account

Balances in the highway account are gradually depleted under CBO's current baseline because estimated outlays exceed estimated revenues each year from 2003 through 2012. Over the next 10 years, projected outlays from the highway account average \$37.1 billion annually, while receipts average only \$33.4 billion.

Over the 1998-2001 period, highway account balances grew because receipts to the account averaged \$28.8 billion a year and outlays averaged \$24.9 billion. Over the same period, however, the highway programs received significant increases in funding. Many obligations have not been discharged yet, and the program's unpaid obligations are now 22 percent higher than they were at the end of 1998. Because many existing obligations must be met with future tax receipts, new spending will be constrained both by receipts and by outlays for previous years' obligations.

The Mass Transit Account

Like the balances of the highway account, the balances of the mass transit account are gradually depleted under CBO's baseline. Over the next 10 years, outlays will average \$5.9 billion a year, CBO estimates, and receipts will average \$5.3 billion.

One feature of funding for the mass transit programs is the Treasury's use of an expenditure transfer from the trust fund to the general fund. Budgetary resources for mass transit programs come from both the Highway Trust Fund and the general fund. In implementing the budget, the Treasury merges resources from those funds by recording the transfer as an outlay from the trust fund and a receipt to the general fund. The result of the expenditure transfer between government accounts is that the balances of the mass transit account are depleted faster than the money is actually paid out by the Treasury.

The Administration uses expenditure transfers under two different circumstances: whenever one budget account buys goods or services from another account or whenever resources are transferred between a trust fund account and a non-trust fund account. That policy is applied throughout the federal budget.

If administrative procedures were changed so as to leave mass transit resources in the trust fund until they were spent, balances in the transit account would reach zero under CBO's baseline somewhat later than is now projected. A change of that type would not affect the budget's overall surplus or deficit, but it would boost the bal-

ances of the mass transit account. Balances would still gradually decline, however, as long as spending exceeded receipts.

BALANCES IN THE HIGHWAY ACCOUNT UNDER VARIOUS ALTERNATIVES FOR SPENDING

At the request of Committee staff, CBO projected balances in the highway account under three different obligation limitations for 2003 for the Federal-Aid Highway program. (Under the current baseline, CBO projects an obligation limitation of \$32.4 billion for the program in 2003.) For those alternatives, CBO varied only the assumptions governing the Federal-Aid Highway program; estimated receipts and outlays for all other trust fund programs were kept at their baseline levels. My discussion of these alternatives focuses solely on the highway account.

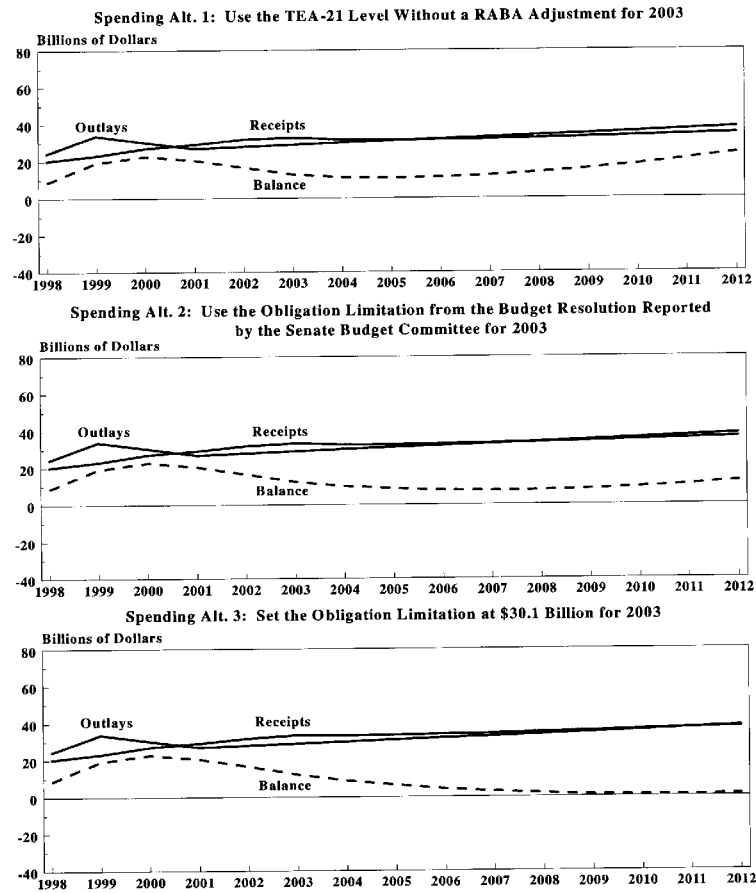
Spending Alternative 1: Use the TEA-21 Level Without a RABA Adjustment for 2003

The first alternative would provide the Federal-Aid Highways program with an obligation limitation of \$27.7 billion for 2003 and then inflate that amount for each subsequent year through 2012 (see Figure 2). That obligation limitation for 2003 would equal the amount authorized under TEA-21 but without the negative RABA adjustment of \$4.4 billion. Under this alternative, the highway account's balances would drop to about \$11 billion in 2005 and then gradually increase over the following years. The highway account would not fail the Byrd test under this alternative.

Spending Alternative 2: Use the Obligation Limitation from the Budget Resolution Reported by the Senate Budget Committee for 2003

The second alternative would set the obligation limitation for the Federal-Aid Highway program for 2003 at \$28.9 billion and then inflate that amount for each subsequent year. The limitation for 2003 is the amount assumed in the version of the 2003 budget resolution reported by the Senate Budget Committee—Senate Concurrent Resolution 100—on March 22, 2002. (That assumption is identified in S. Report 107-141.) The balances of the highway account under this alternative would drop to about \$7 billion in 2007 and then gradually climb over the following years. Again, under this scenario, the account would not fail the Byrd test during the next 10 years.

FIGURE 2. HIGHWAY ACCOUNT BALANCES UNDER ALTERNATIVE OBLIGATION LIMITATIONS FOR THE FEDERAL-AID HIGHWAY PROGRAM



SOURCE: Congressional Budget Office.

NOTE: TEA-21 = Transportation Equity Act for the 21st Century; RABA = revenue-aligned budget authority.

Spending Alternative 3: Set the Obligation Limitation at \$30.1 Billion for 2003

The third alternative would set the 2003 obligation limitation for the program at \$30.1 billion and then inflate that amount for each subsequent year. Under that spending path, the balances of the highway account would fall below \$1 billion but never reach zero. Once again, the account would not fail the Byrd test over the next 10 years. This alternative approximates the highest possible obligation limitation for 2003 that could be inflated for each year of the baseline period without causing the account's balances to fall to zero.

A spending plan that draws down trust fund balances nearly to zero runs the risk of leaving the fund with insufficient balances to meet its obligations. CBO's projections of the fund's future balances are merely estimates; actual spending or receipts are likely to deviate from that path in one direction or another. For example, spending may vary from historical averages, the economy may rise or fall unexpectedly, or the Congress may appropriate additional resources from the trust fund to pay for unanticipated or emergency expenses.

Table 4 summarizes CBO's estimates of highway account balances under its current baseline and the three alternative spending options for the Federal-Aid Highways program.

BALANCES IN THE HIGHWAY ACCOUNT UNDER VARIOUS ALTERNATIVES FOR RECEIPTS

As requested, CBO projected balances in the highway account under two different options for modifying the receipts credited to the Highway Trust Fund beginning in 2004. For both alternatives, CBO estimated the change in receipts to the highway account as well as the additional amount of spending that those receipts would accommodate. To estimate the additional spending, CBO varied the assumptions governing only the Federal-Aid Highway program. The obligation limitation was set at the highest level possible for 2003 that could be inflated for each year of the baseline period without causing the balances of the highway account to fall to zero. As discussed earlier, that level, under the assumption about receipts from CBO's current baseline, would be \$30.1 billion. For this analysis, estimates of outlays for all other trust fund programs were kept at their baseline levels.

TABLE 4. ESTIMATED HIGHWAY ACCOUNT BALANCES UNDER VARIOUS SPENDING OPTIONS (In billions of dollars)

	Federal-Aid Obligation Limitation, 2003	Average Annual Obligation Limitation, 2003-2012	Average Annual Outlays, 2003-2012	Account Balance, 2012
CBO's Baseline	32.4	35.6	37.1	-20.7
Requested Alternative Paths				
Use the TEA-21 level without a RABA adjustment for 2003	27.7	30.3	32.6	24.0
Use the obligation limitation from the budget resolution reported by the Senate Budget Committee for 2003	28.9	31.7	33.8	12.3
Set the obligation limitation at \$30.1 billion for 2003	30.1	33.0	34.9	1.0

SOURCE: Congressional Budget Office.

NOTES: CBO's baseline estimates of receipts to the highway account average \$33.4 billion annually from 2003 to 2012. CBO used those estimates in analyzing each of the alternatives presented in this table.

TEA-21 = Transportation Equity Act for the 21st Century; RABA = revenue-aligned budget authority.

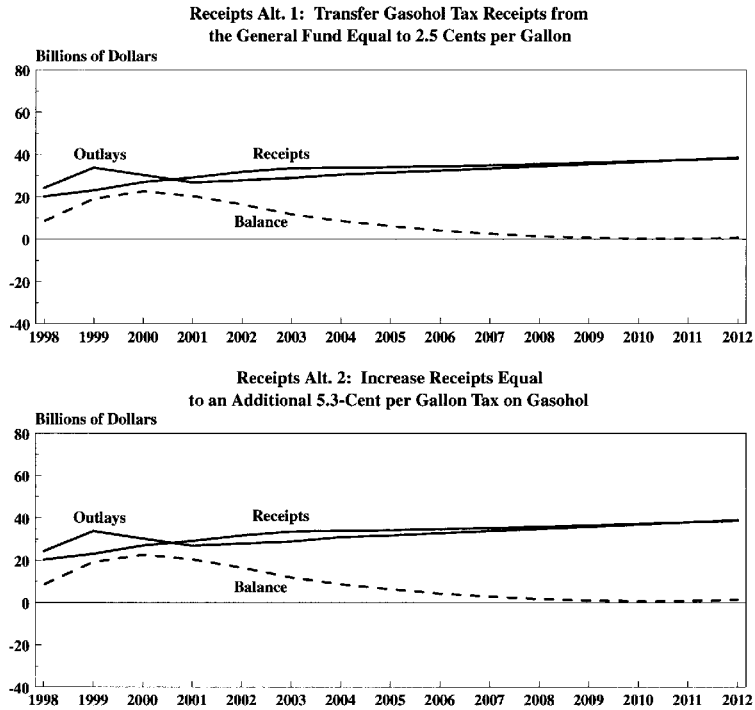
Receipts Alternative 1: Transfer Gasohol Tax Receipts from the General Fund Equal to 2.5 Cents per Gallon

Gasohol is a blend of gasoline and ethanol. Of the total receipts collected from the current tax on gasohol, 2.5 cents per gallon remain in the general fund. Under this alternative, legislation would direct that those receipts be deposited in the highway account instead of the general fund beginning in 2004. The total amount of receipts collected by the federal government would not change, only where such receipts would be recorded in the budget.

This alternative would shift an average of about \$600 million in receipts to the highway account each year, CBO estimates, for a total of \$5.4 billion over the 2004-2012 period. With that shift, the obligation limitation for the Federal-Aid Highway program could be set at \$30.7 billion for 2003 and then increase with inflation for each

of the following years without the highway account's balances dropping to zero over the period (see Figure 3). That obligation limitation is \$600 million more than the highest limitation for 2003 that could be set using the projection of receipts under CBO's current baseline.

FIGURE 3. HIGHWAY ACCOUNT BALANCES UNDER ALTERNATIVE GASOHOL RECEIPTS LEVELS AND OBLIGATION LIMITATIONS FOR THE FEDERAL-AID HIGHWAY PROGRAM



SOURCE: Congressional Budget Office.

Receipts Alternative 2: Increase Receipts to the Highway Account Equal to an Additional 5.3-Cent-per-Gallon Tax on Gasohol

The tax on gasohol is currently lower than the tax on gasoline by 5.3 cents per gallon. Under this alternative, receipts to the highway account could be increased in two ways. Policymakers could enact legislation so that gasohol would be taxed at the same rate as gasoline, increasing overall receipts to the federal government. Or the Congress could require that the Administration estimate the additional receipts that would be collected if the gasohol tax equaled the gasoline tax and then transfer that amount from the general fund to the highway account each year. The transfer would not change the federal government's overall receipts, only where such receipts would be recorded.

CBO estimates that this alternative would either shift or increase receipts to the highway account by an average of about \$1.3 billion annually and a total of \$11.7 billion over the 2004-2012 period. With those receipts deposited in the highway account, the obligation limitation for the Federal-Aid Highway program could be set at \$31.4 billion in 2003 and increase with inflation for each of the following years without the account's balances reaching zero over the next 10 years. That limitation is \$1.3 billion more than the highest limitation for 2003 that could be set using receipts projected under CBO's baseline.

Table 5 summarizes estimated highway account receipts under CBO's current baseline and the two alternatives for gasohol receipts and higher obligation limitations requested by Committee staff.

AUTHORIZING HIGHWAY TRUST FUND BALANCES TO EARN INTEREST

Until the end of fiscal year 1998, the Highway Trust Fund accrued interest on its balances. The Treasury credited the fund with special-issue securities whose interest rate equaled the average rate of all securities that formed the public debt from the previous month. During the time that the trust fund accrued interest, its securities matured twice every year, at the end of June and December. (Today, most securities credited to a trust fund mature only once a year, at the end of June.)

TABLE 5. ESTIMATED HIGHWAY ACCOUNT BALANCES UNDER VARIOUS RECEIPTS OPTIONS (In billions of dollars)

	Average Annual Receipts, 2003-2012	Federal-Aid Obligation Limitation, 2003	Average Annual Outlays, 2003-2012	Account Balance, 2012
CBO's Baseline	33.4	32.4	37.1	-20.7
Requested Alternative Paths				
Transfer gasohol tax receipts from the general fund equal to 2.5 cents per gallon	34.0	30.7	35.5	0.7
Increase receipts equal to an additional 5.3-cent-per-gallon tax on gasohol	34.7	31.4	36.2	0.5

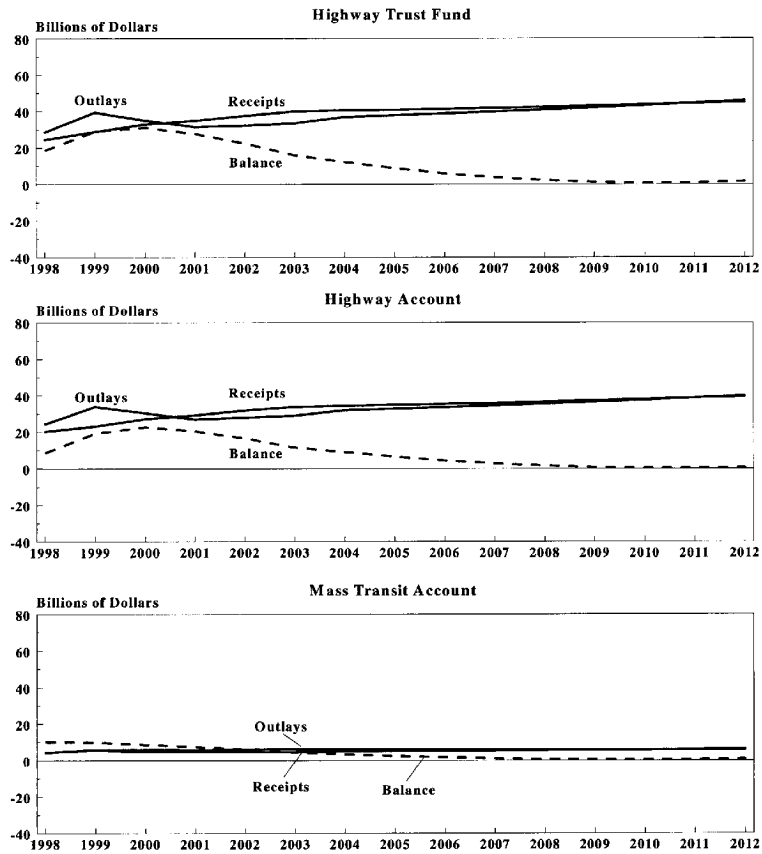
SOURCE: Congressional Budget Office.

As noted earlier, the federal government's trust funds, including the Highway Trust Fund, are accounting mechanisms that record receipts and outlays from a set of budget accounts. For that reason, the securities credited to a fund do not bring the federal government additional receipts. Rather, the securities represent an intragovernmental transfer: when they mature, the general fund is decreased and the trust fund increased by equal amounts.

Although the Treasury continues to credit the Highway Trust Fund with special-issue securities, TEA-21 exempted the fund from the authority to accrue interest. At the request of Committee staff, CBO projected the increase in receipts from returning that authority to the fund beginning in fiscal year 2004. For the purposes of this analysis, CBO assumed that the Treasury would credit the trust fund with special-issue securities carrying an interest rate similar to the rate used before 1999 and that the securities would mature once a year.

My testimony will focus on the results of an approach that includes additional receipts from the two gasohol tax alternatives described earlier. Again, CBO projected the highest level of obligation limitation possible for 2003 for the Federal-Aid Highway program, similar to the analysis provided for receipts alternatives.

FIGURE 4. STATUS OF THE HIGHWAY TRUST FUND WITH ADDITIONAL RECEIPTS FROM BOTH GASOHOL ALTERNATIVES, INTEREST AUTHORITY, AND A DIFFERENT OBLIGATION LIMITATION FOR THE FEDERAL-AID HIGHWAY PROGRAM



SOURCE: Congressional Budget Office.

TABLE 6. ESTIMATED TRUST FUND ACCOUNT BALANCES UNDER THE INTEREST ALTERNATIVE (In billions of dollars)

	Federal-Aid Obligation Limitation, 2003	Average Annual Interest Accrual, 2003-2012	Average Annual Outlays, 2003-2012	Account Balance, 2012
Highway Account CBO's baseline	32.4	0	37.1	-20.7
Requested path: Increase receipts equal to a 7.8-cent-per-gallon tax on gasohol and accrue interest on account balances	32.0	0.2	36.8	1.2
Mass Transit Account CBO's baseline	5.8	0	5.9	*
Requested path: Accrue interest on account balances	5.8	0.1	5.9	0.8

SOURCE: Congressional Budget Office.

* = Balances fall to zero in 2009.

The gasohol alternatives alone would increase highway account receipts by an average of \$1.9 billion annually and by a total of \$17.1 billion over the 2004-2012 period. Interest would bolster receipts by another \$1.9 billion over the period. Highway account balances would accrue about \$550 million in interest in 2004, CBO estimates, but as the balances fell closer to zero, interest would drop, amounting to about \$50 million in 2012.

By crediting the highway account with additional receipts from the gasohol tax alternatives and the interest accrued on balances, the obligation limitation for the Federal-Aid Highway program for 2003 could be set at \$32.1 billion and then increase with inflation for each of the following years without the account's balances falling to zero (see Figure 4). That obligation limitation is \$2 billion more than the highest limitation for 2003 that could be set using the receipts projected under CBO's baseline.

Under this alternative, the mass transit account of the Highway Trust Fund would accrue an average of about \$100 million in interest each year and a total of almost

\$1 billion over the 2004-2012 period. (The gasohol tax proposals would not affect receipts deposited to the mass transit account.) The account's balances would not fall to zero as they do under CBO's baseline, but they would decline to well below \$1 billion for several years.

Table 6 summarizes CBO's estimates of the balances of the highway and mass transit accounts under CBO's baseline with and without the authority to accrue interest.

BALANCES OF THE HIGHWAY TRUST FUND UNDER VARIOUS SPENDING, RECEIPTS, AND INTEREST ALTERNATIVES

My testimony has highlighted how each alternative requested by Committee staff would affect the balances of the highway and mass transit accounts. As discussed earlier, the alternatives for spending and receipts would affect the trust fund independently of each other. Most spending from the fund depends on the budgetary resources provided in appropriation acts, and receipts depend on the collection of various taxes. If trust fund balances accrued interest, however, CBO's projection of additional receipts would depend both on estimated spending and estimated receipts. For example, interest authority would have a different impact on trust fund balances if the Congress also provided higher obligation limitations. In general, the trust fund would be credited with more interest as receipts to the fund increased or as outlays from the fund decreased.

Table 7 summarizes each of the requested alternatives. It includes information about fund balances, obligation limitations, outlays, and receipts for each variation. If the Committee would like CBO to analyze other combinations of those alternatives, we would be happy to provide them for the record.

TABLE 7. SUMMARY OF REQUESTED ALTERNATIVES FOR THE HIGHWAY ACCOUNT (In billions of dollars)

	Federal-Aid Obligation Limitation, 2003	Average Annual Receipts, 2003-2012	Total Receipts Above Baseline Estimates, 2003-2012 ^a	Average Annual Outlays, 2003-2012	Lowest Balance in the Highway Account
CBO's Baseline	32.4	33.4	0	37.1	-20.7
Spending Alternatives					
Use the TEA-21 level without a RABA adjustment for 2003	27.7	33.4	0	32.6	10.8
Use the obligation limitation from the budget resolution reported by the Senate Budget Committee for 2003	28.9	33.4	0	33.8	7.3
Set the obligation limitation at \$30.1 billion for 2003	30.1	33.4	0	34.9	0.6
Receipts Alternatives					
Transfer gasohol tax receipts from the general fund equal to 2.5 cents per gallon	30.7	34.0	5.4	35.5	0.3
Increase receipts equal to an additional 5.3-cent-per-gallon gasohol tax	31.4	34.7	11.7	36.2	*
Interest Alternative					
Increase receipts equal to a 7.8-cent-per-gallon tax on gasohol and accrue interest on account balances	32.1	35.5	19.0	36.8	0.8

SOURCE: Congressional Budget Office.

NOTES: TEA-21 = Transportation Equity Act for the 21st Century; RABA = revenue-aligned budget authority.

* = less than \$50 million.

a. These figures are additional receipts to the highway account and do not necessarily represent increased receipts to the federal government. (Some of the alternatives requested by Committee staff would shift receipts from the general fund to the highway account.)

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P. 2



CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, DC 20515

Dan L. Crippen
Director

July 18, 2002

Honorable Max Baucus
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

The Congressional Budget Office has prepared the enclosed responses to questions for the record following the committee's hearing on the Highway Trust Fund on May 9, 2002.

If you wish further details on these responses, we will be pleased to provide them. The CBO staff contact is Rachel Milberg, who can be reached at 226-2860.

Sincerely,

DC Dan L. Crippen

Enclosure

cc: Honorable Charles E. Grassley
Ranking Member

Honorable Jim Inhofe

Honorable James M. Jeffords

**CBO'S RESPONSES TO QUESTIONS SUBMITTED FOR THE RECORD
FOLLOWING THE MAY 9, 2002, HEARING HELD BY THE SENATE FINANCE
COMMITTEE ON THE HIGHWAY TRUST FUND**

Senator Inhofe's Question

Current law requires that the owner of a truck weighing 55,000 pounds or more is required to pay an annual Heavy Vehicle Use Tax (HVUT) on that truck. This tax can either be paid in one lump sum or in quarterly installments. However, it is my understanding that if the owner sells the truck at any time during the taxable year, that taxpayer is still responsible for paying the full year's HVUT on the vehicle, even if the vehicle is no longer owned by that person. This requirement could force a taxpayer to make quarterly tax payments on a truck that was sold by the taxpayer eight months earlier, which goes against the very concept of "use" taxes.

I would like to know if you would support pro-rating the HVUT to require that a taxpayer only pay the portion of the annual use tax on a truck that corresponds to the portion of the year that truck is actually owned by the taxpayer?

Shouldn't the purchaser of a truck be required to pay the HVUT on that vehicle for the remaining portion of the taxable year?

Furthermore, under this scenario, should it be the responsibility of the taxpayer that sold the vehicle to enforce the tax payment obligations of the purchaser, or is it the responsibility of the IRS to enforce the tax?

Response

Although CBO does not evaluate the fairness of tax policy, the following may help clarify the options that are currently available to truck owners who sell their trucks during the tax year.

Current law requires that an owner of a truck weighing 55,000 pounds or more pay an annual heavy vehicle use tax. The tax is due at the end of June, but it can also be paid in quarterly installments.

When a truck is sold, then either the seller or the buyer is liable for a full year's tax on the truck. Any remaining tax liability at the time of sale may be split between the buyer and seller as part of the sales negotiation. For example, the seller can pay the full amount of the tax but adjust the sales price to cover that cost. It is unlikely that a change in the responsibility for paying the tax would affect who actually bears the burden of it. The relative positions of the buyer and seller would be left unchanged.

Senator Jeffords' Question

I have been an advocate for annual funding to the states under the Federal-Aid Highway program at the maximum level sustainable by the Highway Trust Fund. I define "sustainable" as the level of outlays that can be made while still maintaining a prudent cash balance in the trust fund. Some have suggested that the trust fund should be spent down to zero. Please comment on the need for a cash balance in the Highway Trust Fund and the appropriate level of such a balance.

Response

A spending plan that draws down estimated trust fund balances nearly to zero runs the risk of leaving the fund with insufficient balances to meet its obligations. CBO's projections of the fund's future balances are merely estimates; actual spending or receipts are likely to deviate from that path in one direction or the other. For example, the rate of spending may vary from historical averages, economic activity may rise or fall unexpectedly (resulting in higher or lower tax receipts), or the Congress may appropriate additional resources from the trust fund to pay for unanticipated or emergency expenses.

Hence, it would be prudent to maintain some nonzero balance in the trust fund, but CBO does not make recommendations about the appropriate level of tax collection or spending from federal programs. While we cannot specify an "appropriate" balance for the Highway Trust Fund, some information about the size of CBO's estimating errors in recent years may be useful. The following table compares estimates of the trust fund's balance for the current year with actual balances. Projecting receipts further into the future increases the likelihood of error. CBO's estimate of Highway Trust Fund balances has been off by more than \$1 billion in each of the last three years.

HIGHWAY TRUST FUND BALANCE AT THE END OF THE YEAR (In billions of dollars)

Fiscal Year	CBO Estimate ^a	Actual	Estimating Error
2001	31.6	27.7	3.9
2000	32.3	31.1	1.2
1999	25.3	29.0	-3.7

a. Estimates adopted in CBO baseline projections completed for each year.

GAO

UNITED STATES GENERAL ACCOUNTING OFFICE
Testimony

Before the Committee on Finance
U.S. Senate

For Release on Delivery
Expected at 9:30 a.m. DST
Thursday, May 9, 2002

HIGHWAY FINANCING

Factors Affecting Highway Trust Fund Revenues

Statement of JayEtta Z. Hecker
Director, Physical Infrastructure Issues



Mr. Chairman and Members of the Committee:

We appreciate the opportunity to provide testimony on important Highway Trust Fund issues as the Congress begins to consider the reauthorization of the Transportation Equity Act for the 21st Century (TEA-21). Our statement today is based on our recent reports and testimonies on the Highway Trust Fund and related issues.¹ As you know, the Highway Trust Fund is the principal mechanism for funding federal highway programs authorized by TEA-21. TEA-21 “guaranteed” specific annual funding levels for most highway programs on the basis of projected receipts to the Highway Trust Fund and provided for annual adjustments—referred to as Revenue Aligned Budget Authority (RABA)—to these funding levels on the basis of actual receipts and revised projections of trust fund revenue. This helps to ensure that federal highway program funding levels are linked to Highway Trust Fund receipts. In fiscal year 2003, for the first time, the RABA adjustment is negative—decreasing the guaranteed level of highway funding by \$4.369 billion. While there is general support for continuing to link highway expenditures to receipts in the next reauthorization legislation, there are concerns as to whether future Highway Trust Fund receipts will be sufficient to meet growing transportation needs.

Consequently, you asked us to discuss (1) how tax revenues are distributed into the Highway Trust Fund, (2) our review of the fiscal year 2003 RABA calculation and ways to reduce fluctuations in the RABA adjustment, (3) the impact of gasohol use on the Highway Trust Fund, and (4) industry proposals of ways to increase revenues into the trust fund.

In summary:

- The Department of the Treasury (Treasury) uses a complex process involving four organizations within the department to estimate highway user tax receipts, credit the estimated amounts to the Highway Trust Fund, and subsequently certify and adjust the amounts credited to the fund by analyzing actual payment and tax return data. This process is used because actual data on the specific excise payments are not available at the time these deposits are made. Our past

¹U.S. General Accounting Office, *Highway Funding: Problems with Highway Trust Fund Information Can Affect State Highway Funds*, GAO/RCED/AIMD-00-148 (Washington, D.C.: June 29, 2000); *Applying Agreed-Upon Procedures: Highway Trust Fund Excise Taxes*, GAO-02-379R (Washington, D.C.: Feb. 11, 2002); *Highway Financing: Factors Affecting Highway Funding Fluctuations and Revenue Trends*, GAO-02-527T (Washington, D.C.: Mar. 20, 2002); and *Highway Trust Fund: Overview of Highway Trust Fund Financing*, GAO-02-435T (Washington, D.C.: Feb. 11, 2002). Our work was carried out in accordance with generally accepted government auditing standards.

reports have identified errors and problems with Treasury's excise tax distribution process. However, Treasury has made and continues to make improvements to this process. For example, Treasury recently adopted a new technique for estimating initial distributions to the trust fund to more closely link projections to actual receipts collected. This may have contributed to the adjustment for the fourth quarter of fiscal year 2001 (less than \$100 million) being significantly less than the adjustment for the fourth quarter of the prior fiscal year (\$1.2 billion).²

- We believe the fiscal year 2003 RABA calculation appears reasonable. Although the fiscal year 2003 RABA adjustment of a negative \$4.369 billion is severe, it is largely a reflection of the multiple ways a downturn in the economy affects the calculation. For example, about 80 percent of the fiscal year 2003 RABA adjustment is attributable to the "look back" portion of the RABA calculation, which is made up of two elements. The first element of the look back is the comparison of the actual Highway Account receipts for fiscal year 2001 with the projections of receipts for fiscal year 2001 included in TEA-21. The second element is an adjustment for a portion of the RABA amount provided in fiscal year 2001, which was based on optimistic revenue projection for fiscal year 2001. According to Treasury, actual fiscal year 2001 receipts were lower than expected due to the slowdown in the economy, which especially affected heavy truck sales, and increased gasohol use. Our review shows that the amounts distributed to the Highway Trust Fund for the first 9 months of fiscal year 2001 were reasonable and adequately supported. The remaining 20 percent of the fiscal year 2003 RABA adjustment is due to the "look ahead" portion of the calculation, which compares Treasury's current projections of Highway Account receipts for fiscal year 2003 with the projection of receipts for that year contained in TEA-21. Although we did not independently evaluate the methodology and the economic models Treasury used to develop its revenue projections, our review of a qualitative description of the process, key inputs, and changes to the models plus a comparison of Treasury's projections to those of the Congressional Budget Office (CBO) gave us no reason to question the resulting projections. There are several ways that the RABA adjustment could be changed to help reduce fluctuations in highway funding.
- The use of ethanol-blended fuel (gasohol) instead of gasoline reduces Highway Trust Fund revenue because gasohol is partially exempt from the standard excise tax on gasoline (18.4 cents), and 2.5 cents of the tax received on each gallon of

²We have not reviewed IRS's certification of the receipts for the fourth quarter of fiscal year 2001 to determine if they were reasonable and adequately supported.

gasohol sold is transferred to the General Fund.³ Gasohol was the only Highway Account receipt source to grow from fiscal year 2000 to fiscal year 2001—increasing about 17.5 percent. Because of gasohol's partial tax exemption and General Fund transfer, however, increases in gasohol use and corresponding reductions in gasoline use decrease Highway Account receipts. We estimate that the Highway Account did not receive about \$6.01 billion (in constant 2001 dollars) from fiscal years 1998 through 2001 due to gasohol's partial tax exemption and General Fund transfer. Further, gasohol use is projected to increase; thus, the impact of these tax provisions could grow as well. Using Treasury's projections of gasohol tax receipts, which are based on current law, we estimate that the Highway Account will forgo an additional \$13.72 billion (in constant 2001 dollars) due to the partial tax exemption from fiscal years 2002 through 2012 and \$6.92 billion from fiscal years 2002 to 2012 due to the General Fund transfer (in constant 2001 dollars).⁴ According to Department of Agriculture (USDA) and ethanol industry officials, the partial tax exemption for gasohol helps to create a demand for ethanol and make gasohol prices competitive with gasoline prices.

- Industry groups have proposed a number of ways to increase Highway Trust Fund revenues in order to address future transportation needs. In 2000, the Department of Transportation (DOT) estimated that an average annual investment of \$56.6 billion would be needed over the next 20 years just to maintain the physical condition of existing highways and bridges. Additionally, DOT estimated that an average annual investment of \$10.8 billion would be needed over the next 20 years to maintain the nation's transit systems. These projections coupled with certain trends, such as increased gasohol use and increased fuel efficiency, have contributed to concerns about the long-term ability of the Highway Trust Fund to provide federal funding for transportation needs. To help ensure adequate funding is available for these needs, industry groups have proposed that the trust fund earn interest on its balance. Prior to TEA-21, the Highway Trust Fund earned interest on its balance, which was paid by the General Fund. If the Highway Trust Fund had continued to earn interest on its balance, Treasury estimates that the fund would have earned about \$4 billion from September 1999 through February 2002. Other proposals are aimed

³For the purposes of this testimony, we use the term gasohol to refer to all types of ethanol-blended fuels. Although biomass methanol fuels are also eligible for partial tax exemptions, Treasury does not separately track the small amounts associated with them.

⁴The General Fund transfer expires at the end of fiscal year 2005. To reflect the expiration, Treasury reduces the total federal excise tax on gasohol blends by 2.5 cents starting in fiscal year 2006. Under Treasury's approach, the Highway Account is neither benefited nor harmed by the expiration. For the purposes of this testimony, we estimated the impact of the 2.5 cent General Fund transfer assuming the transfer continued through fiscal year 2012.

at altering the current user tax structure to increase Highway Trust Fund revenue. For example, the taxes levied on heavy trucks could be increased—which would reflect the findings of Federal Highway Administration studies that show the highway user taxes for some heavy trucks do not correspond to the damage they cause to the nation's highways. We have not evaluated the public policy implications of this or other proposals to increase trust fund revenues. Ultimately, the Congress and the administration must assess the long-term sustainability of the trust fund and weigh the advantages and disadvantages of these and other ways to increase revenues.

Background

The Highway Revenue Act of 1956 established the Highway Trust Fund as an accounting mechanism to help finance federal highway programs. According to DOT, the Highway Trust Fund was created as a user-supported fund—that is, the tax revenues of the Highway Trust Fund were dedicated for financing highways, and were to be paid by the highway users. This principle is still in effect, but the tax structure has changed since 1956. In 1983, the Highway Trust Fund was divided into two accounts: a Highway Account and a Mass Transit Account. Receipts to the Highway Account are used to fund highway programs, through which billions of dollars are distributed to the states annually for the construction and repair of highways and related activities.

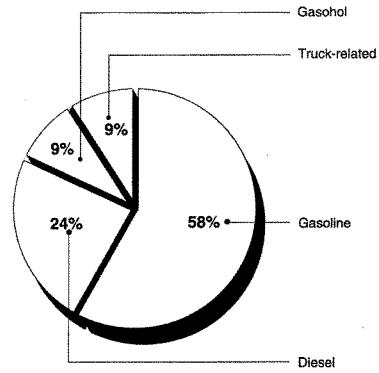
Financing for the Highway Trust Fund is derived from a variety of federal highway user taxes, including excise taxes on motor fuels (gasoline, gasohol, diesel, and special fuels) and tires; sales of new trucks and trailers; and the use of heavy vehicles. (See fig. 1.) As table 1 shows, the excise tax rates and distribution of the tax revenues vary. The different tax rates reflect federal policy decisions. For example, in the 1970s and 1980s, the federal government adopted numerous policies to encourage the use of alternatives to imported fossil fuels and to help support farm incomes. Among these policies were tax incentives that targeted the use of alcohol fuels derived from biomass materials, such as ethanol.⁵ Ethanol-blended fuels (gasohol) are partially exempt from the standard excise tax on gasoline (18.4 cents). The proportion of ethanol contained in each gallon of fuel determines the size of the partial exemption. The most common ethanol blend contains 90 percent gasoline and 10 percent ethanol and is currently taxed at 13.1 cents per gallon—an exemption of 5.3 cents.⁶ The federal

⁵Biomass-derived alcohol fuels are chemical compounds made from nonfossil material of biological origin and constitute a renewable energy source.

⁶Ethanol-blended fuels containing 7.7 percent ethanol and 5.7 percent ethanol qualify for a 4.058 cents and 2.978 cents per gallon exemption, respectively. TEA-21 extended the exemption for gasohol fuels through fiscal year 2007 and provided for a phased-in reduction in the exemption for gasohol.

government also uses the distribution of excise tax receipts to different accounts to achieve policy goals. For example, a small part of the excise tax on most motor fuels is distributed to the Leaking Underground Storage Tank Trust Fund to clean up contamination caused by underground storage tanks. Additionally, 2.5 cents of the tax received on each gallon of gasohol is transferred to the General Fund, rather than the Highway Trust Fund, for deficit reduction purposes.

Figure 1: Tax Revenue Sources of the Highway Trust Fund, Fiscal Year 2001



Source: GAO analysis.

Note: The diesel category includes other fuels, such as liquefied petroleum gas.

Table 1: Excise Tax Rates and Distributions of Highway User Taxes, as of July 2001

Cents per gallon

Type of tax	Tax rate	Distribution of tax			
		Highway Trust Fund		Leaking Underground Storage Tank Trust Fund	General Fund
		Highway Account	Transit Account		
Motor fuels taxes					
Gasoline	18.40	15.44	2.86	0.10	-
Diesel	24.40	21.44	2.86	0.10	-
Alternative fuels taxes					
Gasohol (10% ethanol)	13.10	7.64	2.86	0.10	2.5
Liquefied petroleum gas	13.60	11.47	2.13	-	-
Liquefied natural gas	11.90	10.04	1.86	-	-
M65 (from natural gas)	9.25	7.72	1.43	0.10	-
Compressed natural gas (cents per thousand cu. ft.)	48.54	38.83	9.70	-	-
Truck-related taxes					
Tires:	0-40 lbs, no tax Over 40 lbs - 70 lbs, 15 cents per pound in excess of 40 Over 70 lbs - 90 lbs, \$4.50 plus 30 cents per pound in excess of 70 Over 90 lbs, \$10.50 plus 50 cents per pound in excess of 90				
Truck and Trailer Sales Tax	12 percent of retailer's sales price for tractors and trucks over 33,000 lbs gross vehicle weight (GVW) and trailers over 28,000 lbs GVW				
Heavy Vehicle Use Tax	Annual tax: Trucks 55,000 lbs and over GVW, \$100 plus \$22 for each 1,000 lbs (or fraction thereof) in excess of 55,000 lbs (maximum tax of \$550)				

Note: Tax rates for gasohol mixtures vary according to the amount of ethanol contained in the mixture.

Source: Federal Highway Administration and Treasury.

TEA-21 continued the use of the Highway Trust Fund as the mechanism for accounting for and distributing federal highway user taxes. TEA-21 also established guaranteed spending levels for certain highway and transit programs. Prior to TEA-21, these programs competed for budgetary resources through the annual appropriations process with other domestic discretionary programs. New budget categories were established for highway and transit spending, effectively establishing a budgetary "firewall" between those programs and other domestic discretionary spending programs. Of the \$217.9 billion authorized for surface transportation programs over the 6-year life of TEA-21, about \$198 billion is protected by the budgetary firewall—about \$162 billion for highway programs and \$36 billion for transit programs.

Under TEA-21, the amount of highway program funds distributed to the states is tied to the amount of actual tax receipts credited to the Highway Account of the

Highway Trust Fund. TEA-21 guaranteed specific levels of funding for highway programs from fiscal years 1999 through 2003 on the basis of projected receipts of the Highway Account. TEA-21 also provided that beginning in fiscal year 2000, this guaranteed funding level for each fiscal year would be adjusted upward or downward through the RABA calculation as the levels of Highway Account receipts increased or decreased. To determine the RABA adjustment, the Office of Management and Budget (OMB) and the Office of the Secretary in DOT rely on information on Highway Account receipts and revised Highway Account projections supplied by Treasury. Specifically, the Bureau of Public Debt provides the actual Highway Account receipts for the prior fiscal year; the Office of Tax Analysis (OTA) provides a projection of Highway Account receipts for the next fiscal year.

Treasury Uses a Complex Process to Credit Funds to the Highway Trust Fund

Treasury uses a complex process involving four organizations within the department to estimate highway user tax receipts, credit the estimated amounts to the Highway Trust Fund, and subsequently certify and adjust the amounts credited to the fund by analyzing actual payment and tax return data. Our past reports have identified errors and problems with Treasury's excise tax distribution process.⁷ Treasury has made and continues to make improvements to this process.

In most instances, someone other than the highway user initially pays most highway-related excise taxes. For example, oil companies pay a per-gallon tax on motor fuels at the point where it is loaded into tanker trucks or rail cars at a terminal. Also, tire manufacturers pay taxes on truck tires, by weight, and retailers pay taxes on the sales prices of trucks and trailers. Owners of heavy highway vehicles pay a tax annually on the use of these vehicles, making this the only highway tax directly paid by the highway user. Other highway users pay taxes indirectly, since the costs of these taxes become part of the purchase price of the products taxed.

Most payers of highway user excise taxes make semimonthly deposits to cover their estimated excise tax liabilities, generally through Treasury's Electronic Federal Tax Payment System.⁸ Businesses that make these deposits do not specify which types of excise taxes they are paying with each semimonthly deposit. However, they are required to report the amounts owed for each specific

⁷See, for example, GAO/RCED/AIMD-00-148.

⁸The Electronic Federal Tax Payment System allows taxpayers to make tax deposits electronically. All business taxpayers that have an annual federal tax liability exceeding \$50,000 are required to use this system for making tax deposits.

excise tax on a quarterly tax return due one month after the end of each quarter. When filing the return, the taxpayer is required to make a final payment to make up the difference between the total of semimonthly deposits and the reported total amount owed for the quarter, if the latter amount is greater. Payers of the heavy vehicle use tax generally file returns annually and make payments directly to the Internal Revenue Service (IRS). These payments may be made with the annual returns or through installments.

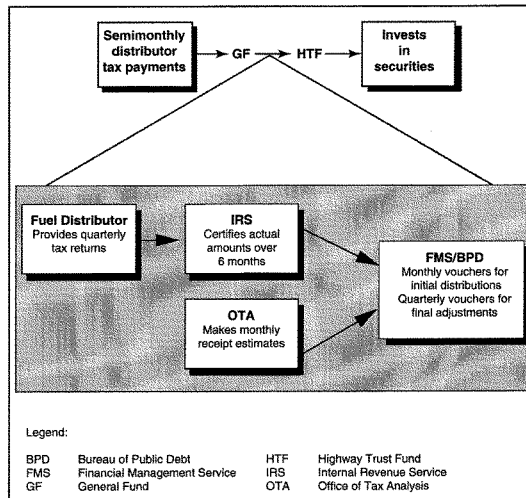
All excise taxes received are deposited into Treasury's General Fund. Because data are not available to determine the amounts of these receipts that represent highway user taxes, Treasury initially uses estimates of highway user tax receipts prepared by OTA to make initial distributions from the Treasury General Fund to the Highway Trust Fund each month. After this initial distribution, IRS certifies quarterly the amounts collected for highway user taxes that should have been distributed to the fund on the basis of tax returns and payment data. However, IRS does not certify collections for each quarter until about 6 months after the quarter ends. IRS needs this period of time to allow for the submission and processing of returns as well as for recording, reviewing, and analyzing payment and tax return data. Following certification, Treasury adjusts the amount initially distributed to the Highway Trust Fund for that quarter. For example, in March 2001, Treasury made an adjustment to decrease the fiscal year 2001 excise tax revenue distributions to the Highway Trust Fund to correct for actual collections in the fourth quarter of fiscal year 2000. The certified fourth quarter receipts were \$1.2 billion less than the amount initially distributed on the basis of OTA's estimates for that quarter. According to an OTA official, OTA had calculated the original estimated transfer amounts for the quarter using an economic model that assumed a higher rate of economic growth through calendar year 2000 than was actually the case.⁹ OTA has since adopted a new estimating technique that more closely links projections to actual receipts collected. This may have contributed to the adjustment for the fourth quarter of fiscal year 2001 being significantly less than the fourth quarter adjustment of the prior year. In particular, on the basis of IRS certifications, the adjustment for the fourth quarter of fiscal year 2001 will be an increase of about \$100 million—that is, the actual receipts collected were about \$100 million more than the amount initially distributed to the trust fund.¹⁰

⁹Prior to December 2000, the distribution process was linked to OTA's receipt estimates for inclusion in the president's budget.

¹⁰We have not reviewed IRS's certification to determine if they were reasonable and adequately supported.

Treasury's Financial Management Service and Bureau of Public Debt share responsibility for making the initial distributions to the Highway Trust Fund, on the basis of OTA's estimates, and subsequent adjustments to these amounts, on the basis of IRS's certifications. The Financial Management Service prepares vouchers for these distributions and adjustments. The Bureau of Public Debt, which maintains accounting records for the fund, uses these vouchers to record and process the distributions and adjustments. (See fig. 2 for an illustration of Treasury's process.) Following the close of each fiscal year, the Bureau of Public Debt prepares a report on the amount of tax receipts that were distributed to the fund during that fiscal year. DOT and OMB use the Highway Account receipts figures in these reports to determine the amounts of highway program funds to be distributed to the states.

Figure 2: Treasury's Process for Distributing Taxes to the Highway Trust Fund



Source: GAO analysis.

Although Treasury has made improvements in its distribution process, other improvements could be made, such as requiring the taxpayer—at the time of the deposit—to indicate the specific types of taxes for which deposits are made. Obtaining this information at the time of the deposit would eliminate the need to rely on estimates for the initial distributions to the trust fund. In June 2000, we recommended that Treasury (1) evaluate and decide whether to use incentives as a near-term method for encouraging taxpayers to provide detailed data—at the time of deposit—on specific types of excise taxes for which deposits are made and (2) reexamine taxpayer capabilities to provide these detailed data and decide

whether to require such data from taxpayers at that time.¹¹ Treasury has not yet acted on our recommendations.

The Calculation of the Fiscal Year 2003 RABA Adjustment Appears Reasonable

On the basis of the information we reviewed, the fiscal year 2003 RABA calculation—a negative \$4.369 billion—appears reasonable. The RABA adjustment for fiscal year 2003 was calculated by (1) comparing the actual Highway Account receipts for fiscal year 2001 with the projections of receipts for fiscal year 2001 included in TEA-21, plus an adjustment for the RABA calculation made for that year (the look back portion of the calculation) and (2) comparing current projections of Highway Account receipts for fiscal year 2003 with the projection of these receipts contained in TEA-21 (the look ahead portion of the calculation). The sum of these differences is the RABA adjustment. Table 2 shows the RABA calculations for fiscal years 2000 through 2003. As shown, the RABA adjustments for fiscal years 2000 through 2002 were positive—increasing highway funding levels by a total of over \$9 billion. However, the RABA adjustment for fiscal year 2003 is a negative \$4.369 billion.

¹¹See GAO/RCED/AIMD-00-148. We also made several recommendations to the secretary of transportation, which were designed to improve the reliability of the Federal Highway Administration's attribution of highway funds to each state.

Table 2: RABA Calculation for Fiscal Years 2000 through 2003

Dollars in millions

Fiscal year	"Look back"		"Look ahead"		RABA
FY 2000	1998 actual Highway Account receipts	\$21,135	2000 estimated Highway Account receipts	\$28,551	
	less: 1998 TEA-21 estimated Highway Account receipts	22,164	less: 2000 TEA-21 estimated Highway Account receipts	28,066	
	less: look ahead result for 1998	0			
	Subtotal	971	Subtotal	485	
FY 2001	1999 actual Highway Account receipts	33,815	2001 estimated Highway Account receipts	30,368	
	less: 1999 TEA-21 estimated Highway Account receipts	32,619	less: 2001 TEA-21 estimated Highway Account receipts	28,506	
	less: look ahead result for 1999	0			
	Subtotal	1,196	Subtotal	1,862	
FY 2002	2000 actual Highway Account receipts	30,534	2002 estimated Highway Account receipts	31,732	
	less: 2000 TEA-21 estimated Highway Account receipts	28,066	less: 2002 TEA-21 estimated Highway Account receipts	28,972	
	less: look ahead result for 2000	485			
	Subtotal	1,783	Subtotal	2,760	
FY 2003	2001 actual Highway Account receipts	26,900	2003 estimated Highway Account receipts	28,570	
	less: 2001 TEA-21 estimated Highway Account receipts	28,506	less: 2003 TEA-21 estimated Highway Account receipts	29,471	
	less: look ahead result for 2001	1,862			
	Subtotal	(1,468)	Subtotal	(901)	

Note: Actual receipts reflect certified net tax receipts (excluding fines and penalties) after deduction of transfers and refunds for the first three quarters of the fiscal year plus an estimate for the fourth quarter. To account for the differences between actual and estimated receipts for the previous year's fourth quarter, Treasury makes an adjustment to the current fiscal year's receipts. Treasury prepares forecasts of tax receipts to the Highway Account of the Highway Trust Fund for the president's budget and other analyses. GBO prepared the estimates of Highway Account receipts contained in TEA-21.

Source: DOT and Treasury.

Look Back Component Is the Major Reason for the Negative RABA Adjustment

Eighty percent of the fiscal year 2003 RABA adjustment is attributable to the look back portion of the calculation. The actual fiscal year 2001 Highway Account receipts were about \$1.6 billion lower than projections in TEA-21. According to Treasury, the lower-than-expected highway excise tax receipts in fiscal year 2001 were due to several factors. Most importantly, the weakened economy contributed to a decline in highway excise taxes paid. All but one of the Highway Trust Fund receipt sources were lower in fiscal year 2001 than fiscal year 2000. For example, tax revenue from the retail tax on new trucks dropped 55 percent from fiscal years 2000 to 2001. Additionally, the rise in the use of gasohol at the expense of gasoline contributed to decreased Highway Account receipts. The amount of gasohol receipts allocated to the Highway Account rose by 17.5 percent between fiscal years 2000 and 2001, which Treasury believes is evidence of an ongoing substitution of gasohol fuels for gasoline. Because gasohol is taxed at a lower rate than gasoline and a portion of the tax on gasohol is transferred to the General Fund, increases in gasohol use and corresponding

reductions in gasoline use decrease Highway Account revenues. On February 11, 2002, we issued a report on the results of procedures we performed related to the distributions of excise tax revenue to the Highway Trust Fund in fiscal year 2001.¹² On the basis of this work, we believe the amounts distributed to the Highway Trust Fund for the first 9 months of fiscal year 2001, which were subject to IRS's quarterly excise tax certification process and which were adjusted on the basis of this process, were reasonable and were adequately supported according to available information.¹³

Look Ahead Component Also Contributed to Negative RABA Adjustment

Although not the main factor, the look ahead portion of the RABA calculation also contributed to the overall negative RABA adjustment. As previously discussed, the look ahead is the difference between TEA-21's projections for the next fiscal year to current projections from the president's budget, which are prepared by Treasury. We did not independently evaluate the methodology and the economic models Treasury used to develop its revenue projections. However, on the basis of the general qualitative description Treasury provided us about its methodology and economic models used to develop Highway Trust Fund revenue projections, we have no reason to question the projections for fiscal year 2003. Treasury uses seven econometric models to forecast each highway excise tax revenue source, such as the tax on gasoline. These models seek to approximate the relationship between historical tax liability and current macroeconomic variables, such as the gross domestic product. This estimated relationship is the baseline, and Treasury uses it to project future excise tax liability, given current law and the administration's economic assumptions. After calculating future tax liability, Treasury forecasters convert the tax liability forecast to a tax receipts forecast using information on deposit rules, payment patterns, and actual collections.

The administration's economic assumptions drive the projections made with each model. According to Treasury, receipts forecasting is a policy exercise conducted for the president to show the state of all revenue sources—including the Highway Trust Fund—if the administration's economic assumptions were to come to fruition. Consequently, Treasury's forecasts incorporate economic assumptions formulated for the budget by the "Troika," which consists of the Council of Economic Advisors, OMB, and Treasury. Because the goal is to provide a forecast consistent with these economic assumptions, the models use these assumptions directly as explanatory variables, or link other explanatory

¹²GAO-02-379R.

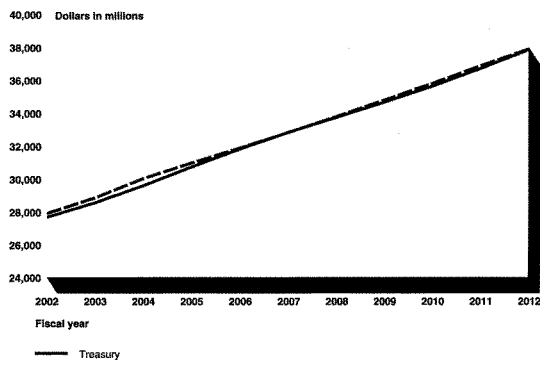
¹³Additionally, on the basis of our review, we believe the March 2001 adjustment made by Treasury to reduce fiscal year 2001 excise tax distributions to the Highway Trust Fund by \$1.2 billion was reasonable and adequately supported.

variables to the assumptions provided. While several of the administration's economic assumptions are publicly available, such as the gross domestic product and consumer price index, most Troika assumptions are not publicly available, such as the projected price of gasoline. Other variables specific to the Highway Trust Fund are included in the economic models. Treasury generally obtains this information from other federal agencies. For example, Treasury incorporates USDA's forecast of ethanol use in its gasohol model. However, according to Treasury, the forecasters must ensure that the addition of these other variables does not create inconsistencies between the projections and the administration's assumptions.

It should also be noted that Treasury does not try to predict future regulatory or legislative changes at the federal or state levels that could affect Highway Trust Fund revenue but bases its projections on current law. Any legislative or regulatory changes that affect Highway Trust Fund revenue will affect the accuracy of the forecasts. Treasury continuously updates its models to incorporate legislative, economic, and other relevant changes—which are then reflected in the next forecasting exercise.

In addition to reviewing qualitative descriptions of Treasury's model, we also compared the model's projections with CBO's forecasts. This comparison did not raise any questions about the reasonableness of Treasury's projections. For example, despite different methodologies and assumptions, Treasury and CBO projections of Highway Account receipts for the budget window are very similar. (See fig. 3.) Both agencies forecast steady growth in receipts from fiscal years 2002 through 2012. For example, both Treasury and CBO project the average annual growth of highway-related excise taxes will be about 3 percent.

Figure 3: Comparison of Treasury and CBO Projections of Highway Account Receipts, Fiscal Years 2002 to 2012



Source: Treasury and CBO.

\$600 Million Error in RABA Adjustment Occurred Outside of Treasury's Models

In January 2002, the administration announced that the fiscal year 2003 RABA adjustment would be a negative \$4.965 billion. The administration subsequently announced that an error had been made in calculating the RABA adjustment and that the correct amount was a negative \$4.369 billion—a \$600 million difference.

The error, which was made in Treasury's allocation of projected highway tax revenues to various accounts rather than in its economic models, affected the look ahead part of the fiscal year 2003 RABA calculation. Specifically, it occurred in Treasury's allocation of projected revenues from gasohol sales to the General Fund, the Leaking Underground Storage Tank Trust Fund, and the Highway and Transit Accounts within the Highway Trust Fund. In short, the error resulted in the incorrect distribution of projected gasohol receipts among the funds.

Because gasohol has six different blends—all with different tax rates and distributions—the gasohol allocations are complicated and require many "links" among several spreadsheets. With respect to gasohol, the Highway Account receipts are calculated after allocations for the other accounts—the Mass Transit

Account, the Leaking Underground Storage Tank Trust Fund, and the General Fund—have been calculated. This is because the Highway Account is a “catch-all” for taxes that are not already attributed to other accounts. A misalignment occurred among the different spreadsheets used to distribute gasohol tax revenues to the different accounts, which caused too much of the gasohol revenues to be transferred to the General Fund. Consequently, the error incorrectly lowered projected Highway Account revenue beginning with fiscal year 2002.

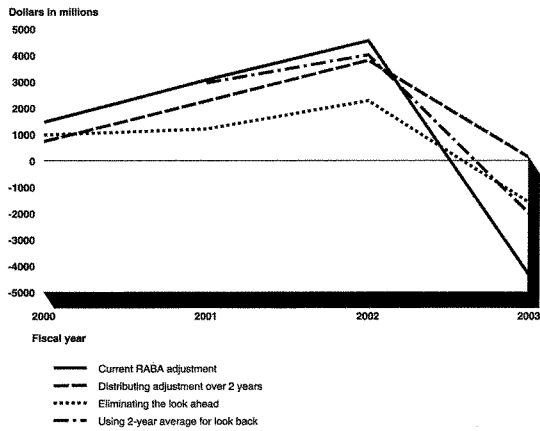
According to a Treasury official, a number of factors contributed to the error, including tightened time constraints during this budget cycle for Treasury forecasters to calculate and review their projections for the fiscal year 2003 budget. Each forecaster is responsible for reviewing his/her own calculations. In hindsight, however, this official said that the internal quality checks his office made were insufficient, especially on the gasohol calculations, which are very complex. He noted that Treasury plans to take several steps to avoid such an error in the future, including requiring Treasury’s forecasters to have their projections spot-checked by other department forecasters.

Possible Ways to Reduce RABA Fluctuations

The RABA formula, as defined by TEA-21, contains look back and look ahead components that tend to accentuate the impact of any shifts in Highway Account receipts. For example, the recent downturn in the economy is reflected in several elements of the fiscal year 2003 RABA calculation. First, the actual receipts for fiscal year 2001 were lower than expected. Second, the downturn made it necessary to correct for optimistic projections of fiscal year 2001 receipts made in December 1999. Third, the fiscal year 2003 projections are lower than those contained in TEA-21 because the updated projections reflect the current economic conditions.

Several changes could be made to reduce the potential for dramatic swings in funding for highway programs but maintain a tie to actual receipts credited to the Highway Account. For example, changes to the RABA adjustment that could smooth out the impact of significant funding changes could include (1) eliminating the look ahead part of the RABA calculation, (2) averaging the look back part of the calculation over 2 years, and (3) distributing the RABA adjustments over 2 years. In figure 4, we show the actual RABA adjustments under the current structure and the adjustments that would have been made using these three options from fiscal years 2000 through 2003.

Figure 4: Comparison of Different RABA Options



Source: GAO analysis.

As shown in figure 4, the three options appear to produce less dramatic shifts in funding than the current RABA mechanism over the past 4 years. However, we did not analyze how these options would perform against different Highway Trust Fund scenarios or economic cycles in the future.

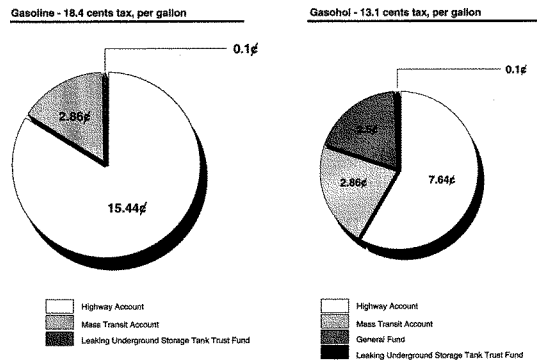
Gasohol Use Has Significant Impact on Trust Fund Revenues

The use of gasohol instead of gasoline affects the amount of Highway Account revenue for two reasons. First, gasohol is partially exempt from the standard gasoline excise tax. Second, 2.5 cents of the tax received on each gallon of gasohol sold is transferred to the General Fund. (See fig. 5.) We estimate that the partial tax exemption resulted in \$3.86 billion in revenue forgone by the Highway Account during fiscal years 1998 through 2001.¹⁴ We also estimate

¹⁴All estimates of revenue forgone by the Highway Account are presented in constant 2001 dollars.

that the General Fund transfer reduced Highway Account revenue by \$2.15 billion during the same period.

Figure 5: Distribution of Gasoline and Gasohol Taxes to Different Accounts



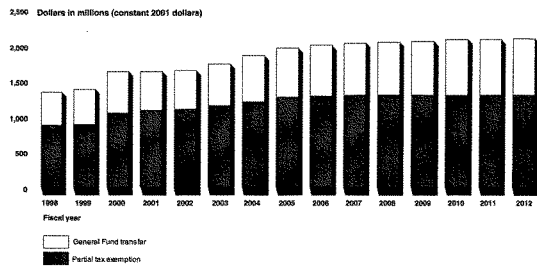
Note: This figure reflects the tax rate and distribution of the gasohol blend containing 90 percent gasoline and 10 percent ethanol. Tax rates and distributions for other gasohol blends vary according to the amount of ethanol contained in the blend.

Source: GAO analysis.

Treasury projects that gasohol use will continue to rise steadily through fiscal year 2012. According to Treasury, such an increase will occur at the expense of gasoline because some states are in the process of banning or phasing out the use of methyl tertiary-butyl ether (MTBE) as an oxygenate additive resulting in greater use of ethanol. Using Treasury's highway excise tax revenue projections, we estimate that the partial tax exemption will lower Highway Account revenue by a total of \$13.72 billion from fiscal years 2002 through 2012. We also estimate that the Highway Account will not receive \$2.36 billion due to the General Fund transfer from fiscal years 2002 through 2005, when the transfer

ends.¹⁵ In addition, if the amount of the transfer is not dedicated to the Highway Account following fiscal year 2005, we project that the Highway Account will forgo \$4.56 billion from fiscal years 2006 through 2012. Figure 6 depicts and table 3 summarizes the estimated revenue forgone from fiscal years 1998 to 2012 by the Highway Trust Fund because of the gasohol tax provisions.

Figure 6: Estimated Revenue Forgone by the Highway Account Due to Gasohol Tax Provisions



Note: Estimates for fiscal years 1998 to 2000 are based on actual excise taxes collected. We estimated fiscal year 2001 receipts using actual receipts collected for the first three quarters and a projection of receipts collected for the fourth quarter. Estimates for fiscal years 2002 to 2012 are based on Treasury's projections. Estimates are in constant 2001 dollars.

Source: GAO analysis.

¹⁵The General Fund transfer expires at the end of fiscal year 2005. To reflect the expiration, Treasury reduces the total federal excise tax on gasohol blends by 2.5 cents per gallon starting in fiscal year 2006. Under Treasury's approach, the Highway Account is neither benefited nor harmed by the expiration. For the purposes of this testimony, we estimated the impact of the 2.5 cent General Fund transfer assuming the transfer continued through fiscal year 2012.

Table 3: Estimated Revenue Forgone by the Highway Account Due to Gasohol Tax Provisions

Dollars in millions (constant 2001 dollars)

Tax provision	1998 to 2001		2002 to 2012	
	Total	Average	Total	Average
Partial tax exemption	\$3,856	\$964	\$13,716	\$1,247
General Fund transfer	\$2,154	\$539	\$6,921	\$629
Combined impact	\$6,011	\$1,502	\$20,637	\$1,876

Note: Estimates for fiscal years 1998 to 2000 are based on actual excise taxes collected. We estimated fiscal year 2001 receipts using actual receipts collected for the first three quarters and a projection of receipts collected for the fourth quarter. Estimates for fiscal years 2002 to 2012 are based on Treasury's projections. Estimates are in constant 2001 dollars.

Source: GAO analysis.

According to USDA and ethanol industry officials, the partial tax exemption for gasohol is intended to create a demand for ethanol that will raise the price of ethanol at least to the point where producers can cover costs. These officials stated that if the partial tax exemption on ethanol was removed, the price of ethanol would no longer be competitive with the price of gasoline and the demand for ethanol would disappear. In this case, ethanol fuel production would not, for the most part, continue. Furthermore, ethanol industry officials we talked to warned that because a substantial amount of the corn grown in the United States is used for ethanol, the collapse of the ethanol industry would affect the corn and agriculture markets, which could in turn affect the federal government's agricultural support payments.

Industry Groups Propose Ways to Increase Highway Trust Fund Revenues

Industry groups have proposed a number of ways to increase Highway Trust Fund revenues in order to address future transportation needs. In 2000, DOT estimated that an average annual investment of \$56.6 billion would be needed over the next 20 years just to maintain the physical condition of existing highways and bridges. Additionally, DOT estimated that an average annual investment of \$10.8 billion would be needed over the next 20 years to maintain the nation's transit systems. Under its current baseline, CBO estimates that trust fund outlays exceed revenues each year from fiscal year 2003 to fiscal year 2012. Therefore, CBO estimates that the Highway Account balance will be depleted in

2006 and that the balance of the Mass Transit Account will hit zero in 2009.¹⁶ These projections coupled with certain trends, such as growing gasohol use and increased fuel efficiency, have contributed to concerns about the long-term ability of future Highway Trust Fund revenues to meet federal transportation needs.

Industry groups and others have advanced a number of proposals to increase future revenues, such as crediting the Highway Trust Fund for the interest earned on its balances, increasing the use of tolls, and/or establishing an indexing system to help ensure that gas tax rates are linked to inflation. Although each of these actions would increase Highway Trust Fund revenues, we have not evaluated their public policy implications. The discussion that follows is not intended to show support for any possible alternatives but instead to describe some of the possible ways that highway funding could be increased.

One way cited to enhance Highway Trust Fund revenues would be to allow the Highway Trust Fund to earn interest on its balance. Prior to TEA-21, the Highway Trust Fund earned interest on its balance, which was paid by the General Fund. According to Treasury figures, if this had been done since TEA-21 was enacted, the Highway Trust Fund would have earned about \$4 billion from September 1999 through February 2002.¹⁷

Another way to increase Highway Trust Fund revenues would be to increase highway excise taxes. Although no tax increase is attractive, there are some equity arguments that support an increase in certain highway user taxes. For example, for some time the Federal Highway Administration has reported that heavy trucks (trucks weighing over 55,000 pounds) cause a disproportionate amount of damage to the nation's highways and have not paid a corresponding share for the cost of the pavement damage they cause. Currently, heavy vehicles are taxed at the rate of \$100 per year plus \$22 for every 1,000 pounds (or fraction thereof) they weigh over 55,000 pounds. However, the tax is capped at \$550. In 2000, we reported that the Joint Committee on Taxation estimated that raising the

¹⁶CBO's baseline projections of tax receipts for fiscal years 2003 through 2012 assumes that current tax laws remain in place and that scheduled changes and expirations occur on time. The only exception to that rule is the treatment of excise taxes dedicated to trust funds, including the Highway Trust Fund. For CBO's baseline projections of outlays for the Highway Trust Fund, CBO assumes that policy-makers will continue to control spending through obligation limitations set in annual appropriations acts. CBO's estimates of the fund's outlays are based on historical spending patterns. We did not evaluate CBO's methodology or projections.

¹⁷Treasury's Bureau of Public Debt developed this estimate using an interest rate calculated by the Office of Market Finance. In general, the interest rate is the monthly average of all marketable interest rates in the United States.

ceiling on this fee to \$1,900 could generate about \$100 million per year.¹⁸ Another option would be to restructure the existing truck-related user taxes. For example, according to CBO, replacing the three truck-related excise taxes (i.e., taxes on tires, sales of new trucks and trailers, and the use of heavy vehicles) with a single per-mile tax that is based on a vehicle's weight and number of axles would better align the taxes a truck pays with the damage it does to the roads. Depending on the rate of taxation, this change could generate additional revenue for the Highway Trust Fund.

In summary, Mr. Chairman, the Congress and the administration must ultimately assess the long-term ability of the Highway Trust Fund to meet surface transportation needs. The advantages and disadvantages of changing the trust fund revenue streams must be weighed against future transportation needs and other national priorities. The upcoming reauthorization of surface transportation programs provides an opportunity to explore proposals to increase trust fund revenues. We stand ready to assist the Congress in examining these issues.

This concludes my prepared remarks. I would be pleased to answer any questions you or other members of the subcommittee may have.

Contact and Acknowledgments

For questions regarding this testimony, please contact JayEtta Z. Hecker on (202) 512-2834 or at heckerj@gao.gov. Individuals making key contributions to this testimony included Nikki Clowers, Helen Desaulniers, Ted Hu, Mehrzad Nadji, Stephen Rossman, Steven Sebastian, Ron Stouffer, and James Wozny.

¹⁸U.S. General Accounting Office, *Budget Issues: Budgetary Implications of Select GAO Work for Fiscal Year 2001*, GAO-OCG-00-8 (Washington, D.C.: Mar. 31, 2000).



Highway Financing

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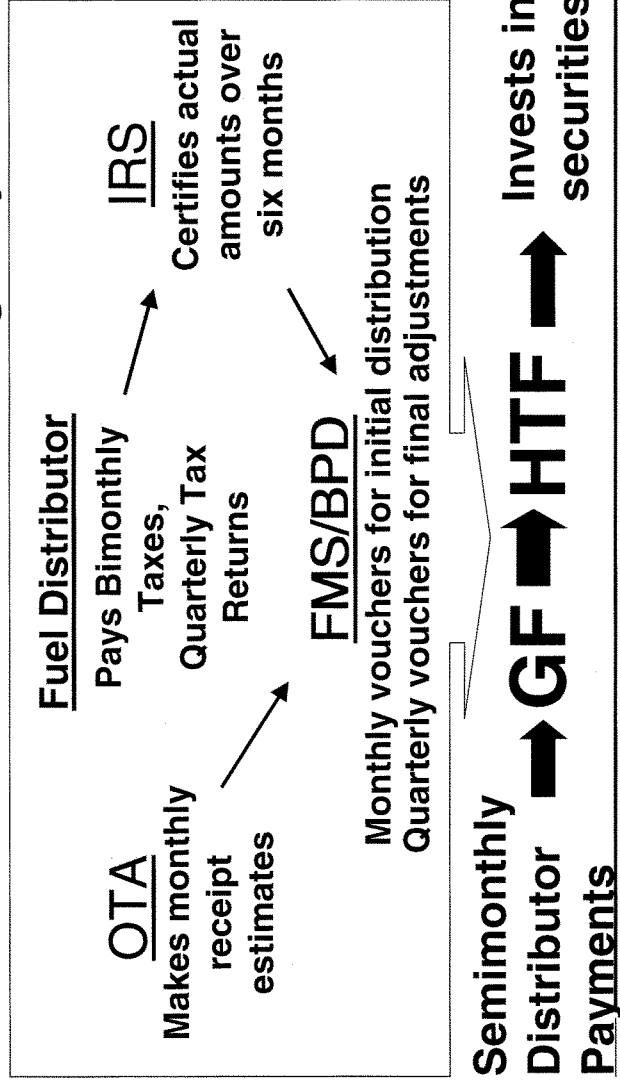
Factors Affecting Highway Trust Fund Revenues

Testimony before the Committee on Finance
U.S. Senate
May 9, 2002

Overview

- I. Collection and distribution of highway taxes**
 - II. Reasonableness of the 2003 RABA calculation**
 - III. Impact of gasohol use on the Highway Trust Fund**
 - IV. Industry's and others' proposals to increase Highway Trust Fund revenue**
-

Collection & Distribution of Highway Taxes

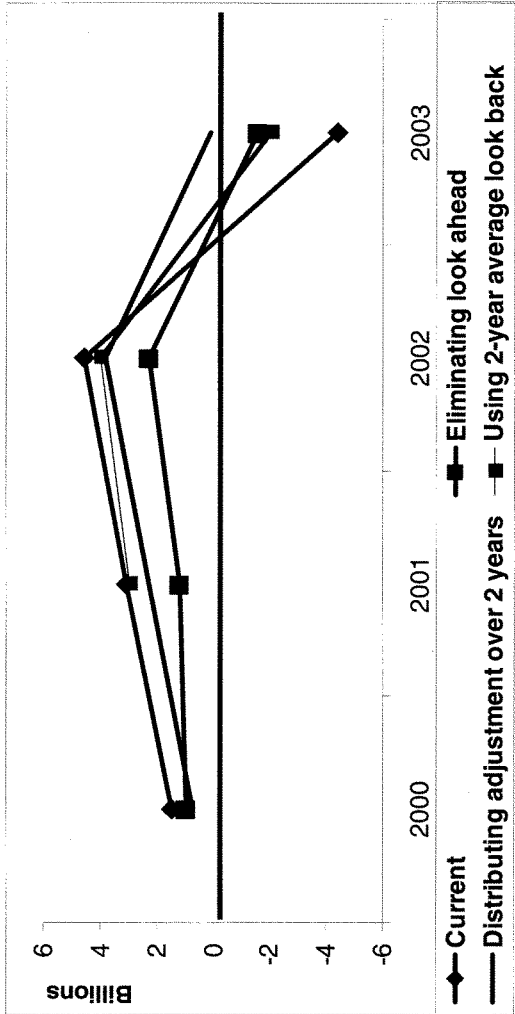


FY 2003 RABA Calculation

FY	Look Back	Look Ahead	RABA
2	1999 HA receipts: \$33,815	2001 est. \$30,368	
0	- 1999 TEA-21 est: \$32,619	- <u>TEA-21 est.: \$28,506</u>	
0	- 1999 look ahead: \$ 0		
1	\$1,196	\$ 1,862	\$3,058
2	2001 HA receipts: \$26,900	2003 est. \$28,579	
0	- 2001 TEA-21 est: \$28,506	- <u>TEA-21 est: \$29,471</u>	
0	- 2001 look ahead: \$1,862		
3	\$3,468	\$901	\$4,369

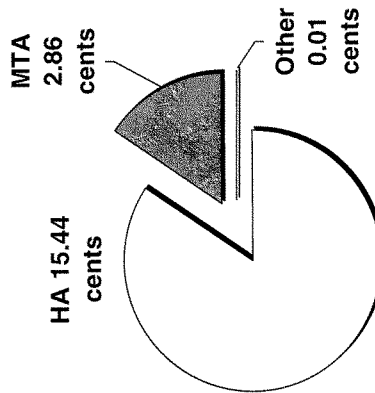
Amounts in millions

RABA Formula Could Be Changed to Reduce Fluctuations

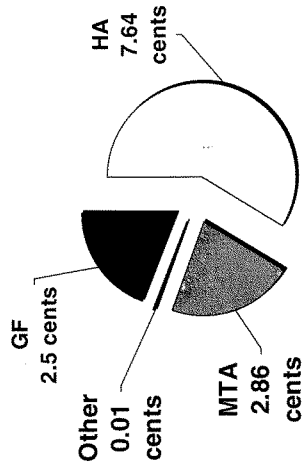


Use of Gasohol Impacts Highway Trust Fund Revenue

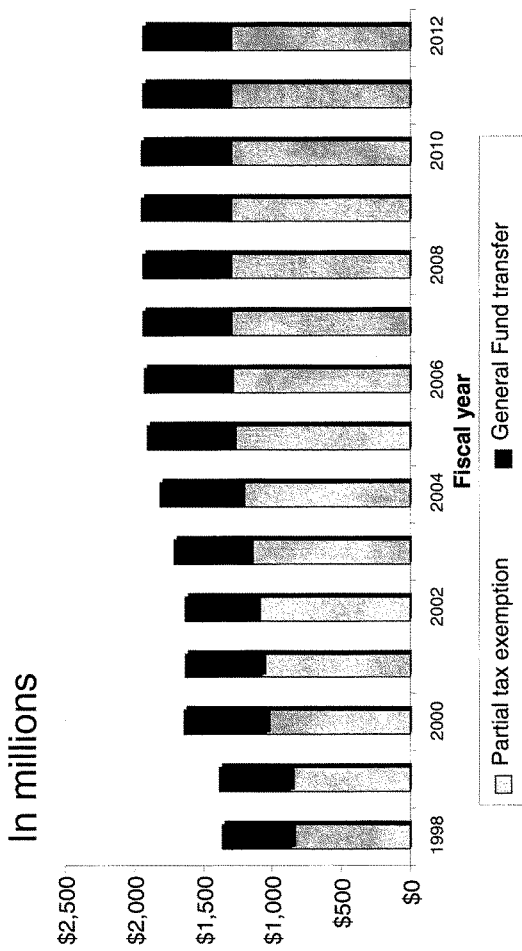
Gasoline
 18.4 cents



Gasohol
 13.1 cents



Estimated Revenue Forgone Due to Gasohol Tax Provisions





Industry's and Others' Proposals to Increase Revenue

- **Allow the Highway Trust Fund balance to accrue interest**
- **Increase use of tolls**
- **Modify highway user taxes**

Summary

- **Concerns about the sustainability of the Highway Trust Fund**
- **Opportunities as presented by the upcoming reauthorization**

**Questions for the Record Submitted by
Senate Finance Committee Members to GAO**

Response to question submitted by Senator Jim Inhofe regarding heavy vehicle use tax

We have done no recent work on how annual heavy vehicle taxes are applied, collected, and/or enforced—therefore, we do not have a position on any proposal to change how these taxes are paid; more specifically we don't have a position on your proposal to prorate this tax if the vehicle is owned by more than one party during the year. In past reports and testimonies GAO has pointed out that the existing "cap" on heavy vehicle taxes reduces the total amount of truck taxes paid compared to those paid by automobile owners. This in turn raises tax equity questions, since trucks cause more damage to highways than cars. We note, however, that the Joint Committee on Taxation recently completed a study of the federal tax system and recommended that all non-fuel Highway Trust Fund taxes such as heavy vehicle and truck tire taxes be eliminated (or more accurately "rolled up" into fuel taxes or a vehicle miles traveled tax structure) in order to simplify trust fund tax collection and reduce enforcement and oversight costs. Furthermore, the Congressional Budget Office also recently concluded a review of trust fund excise taxes and reported that replacing truck-related taxes with a single per-mile tax that is based on a vehicle's weight and number of axles would better align the taxes a truck owner pays with the damage the truck does to the nation's roads.

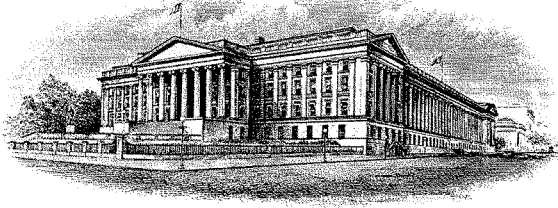
Response to question submitted by Senator Jeffords asking for us to comment on the need for a cash balance on the Highway Trust Fund

The balance of the highway account was \$20.4 billion at the end of fiscal year 2001. The balance existed because as of October 1, 2001, more money had been taken into the trust fund than expended. However, this balance does not represent excess cash, because the fund is committed to pay for outstanding obligations associated with ongoing highway programs. This point can perhaps be made clearer by comparing the trust fund to an individual's charge account. For discussion purposes, let's assume an individual has cash on-hand but not enough to pay his total monthly charges. In this case, the cash cannot be considered excess because it is needed to pay the incoming charges. On the other hand, the individual is not in a deficit situation because by the end of the month his monthly paycheck will be available to help pay the outstanding charges. Thus, the cash the individual has on-hand plus future income helps to ensure that there will be sufficient funds to pay all outstanding charges. Similarly, the fiscal year 2001 highway account balance of \$20.4 billion needs to be compared to outstanding obligations of highway programs, which total about \$40 billion. These obligations will be met using the existing balance plus future highway account revenue.

The appropriate trust fund balance has been the subject of debate and discussion for many years. When the Congress established the trust fund in 1956, it initially addressed the need for maintaining a minimum balance by establishing a safety mechanism, referred to as the Byrd Amendment, to ensure that sufficient funds would be available to liquidate commitments at the end of each fiscal year. The Byrd Amendment permits the total of projected unpaid commitments against the trust fund at the close of any fiscal year to exceed the end-of-year balance, as long as projected income for the following 2 fiscal years will be sufficient to cover

the commitments. If the balance plus projected income does not cover outstanding commitments, proportionate reductions to the amounts apportioned to all programs must be made.

If one assumes, for analytical purposes that the federal-aid highway program will not be extended and that no new commitments will be made beyond fiscal year 2001, the trust fund's highway account would continue to receive deposits through fiscal year 2003. This infusion of revenue is expected to be sufficient to pay off all existing commitments and leave an estimated balance of over \$35 billion that could be used to support future authorizations. Because revenue forecasts can and do change, DOT advocates that a minimum level or "safety cushion" should be maintained in the highway account. Once this level is reached, they would argue that additional future obligations should be curtailed. Determining the appropriate level of this safety cushion—that is, a minimum highway account balance that would maximize future trust fund investments in highways but still provide assurance that all future obligations will be met—is a policy decision for Congress.



DEPARTMENT OF THE TREASURY

EMBARGOED UNTIL DELIVERY
May 9, 2002

Contact: Tara Bradshaw
(202) 622-2014

**Statement of
Andrew Lyon, Deputy Assistant Secretary for Tax Analysis
United States Department of the Treasury
Before the Committee on Finance
United States Senate
Hearing on Revenue Issues Related to the Highway Trust Fund**

Mr. Chairman and Members of the Committee, I appreciate the opportunity to describe recent trends in actual highway-related excise taxes, briefly describe how funds are credited to the Highway Trust Fund, discuss the Administration's FY 2003 Budget forecast of related excise taxes, and highlight areas that Treasury is evaluating as a part of its ongoing simplification project.

The Office of Tax Analysis in the Department of the Treasury forecasts most future tax receipts for the President's Budget. These forecasts are made using economic models that are constantly updated to incorporate the most current information on tax collections and reported tax liabilities. The forecast for Fiscal Years 2002 through 2012 incorporates the Administration's economic assumptions formulated for the Budget by the Troika, which consists of the Council of Economic Advisors, the Office of Management and Budget, and the Department of the Treasury.¹ Each of the six dedicated Highway Account excise tax sources are separately forecast: (i) Gasoline, (ii) Gasohol fuels, (iii) Diesel and other fuels, (iv) Retail tax on trucks, (v) Highway-type tires, and (vi) Heavy vehicle use tax. In Table 1, fiscal year receipts for 2000 through 2012 are reported for these six excise tax sources. The 2000 and 2001 figures are actual receipts drawn from the Highway Account Income Statement, while the 2002 through 2012 figures are projections from the President's FY 2003 Budget.²

¹ The economic assumptions are described in Chapter 2 of the Analytical Perspectives volume of the Fiscal Year 2003 Budget.

² The Income Statement for FY 2000 and 2001 includes three quarters of actual tax receipts certified by the IRS. Receipts for the last quarter of the fiscal year are based on an estimated allocation of total excise tax receipts. Any differences between estimated and actual receipts for the last quarter is adjusted in March and reflected in the Income Statement of the subsequent year.

Recent Excise Tax Receipts

There was a rapid downturn in highway-related excise taxes as the economy began weakening in the summer of 2000 and continuing through 2001. Tax receipts deposited in the Highway Account fell \$3.4 billion from Fiscal Year 2000 to Fiscal Year 2001, dropping from \$30.3 billion to \$26.9 billion, an 11.3 percent decline. As shown in Table 1, five of the six receipt sources were lower in 2001 than in 2000. Only taxes on gasohol fuels show an increase.

The increase in taxes on gasohol fuels is evidence of an ongoing substitution of gasohol fuels for gasoline, which may be used interchangeably in cars and light trucks. We anticipate that there will be an increasing use of gasohol fuels as a proportion of total fuel use as States ban the use of MTBE (methyl tertiary-butyl ether) as a fuel additive. Since the Highway Account receives 15.44 cents per gallon of gasoline but only about 8 cents per gallon of gasohol, the substitution of gasohol fuels for gasoline will result in a net reduction in Highway Account receipts.

The most dramatic declines between FY 2000 and FY 2001, both in percentage terms and in dollars, occurred in excise taxes related to the sales and operations of trucks. The retail tax on trucks, a 12 percent tax on the first retail sale of heavy trucks, buses, truck tractors, and trailers, was down 55.2 percent, a decline of more than \$1.8 billion. Tax receipts from the tax on truck tires fell 22.5 percent, and truck use tax receipts fell 33.8 percent. The reductions in retail truck taxes were particularly large because this tax is levied as an ad valorem tax on the first retail sale. During the investment boom of 1998 and 1999, a large volume of new trucks were purchased at premium prices. As the economy weakened, large numbers of these slightly used trucks were placed on the market. This greatly depressed prices and sales in the new heavy truck market, and tax revenues from retail truck taxes declined accordingly.

How Receipts Get to the Highway Trust Fund

Motor fuel, which accounts for more than 90 percent of trust fund receipts, is taxed when it moves out of the bulk transportation and storage network and into tanker trucks at the terminal rack. At this point the fuel is taxed or dyed if it is diesel or kerosene intended for nontaxable purposes. The owner of the fuel as it passes the terminal rack, the registered position holder, is liable for payment of the tax.

Taxpayers with more than \$2,500 in net excise tax liability are required to make semi-monthly estimated payments and typically rely on safe harbor rules in determining the amount to deposit. For example, safe harbor rules permit taxpayers to make deposits of 1/6th of their tax liability from the quarter two quarters prior to the current quarter. These deposits are typically made via the Electronic Federal Tax Payment System and are initially deposited in the Treasury's General Fund. At the time of these deposits, taxpayers are not required to itemize what excise taxes they are depositing; they simply indicate that it is for excise taxes. This deposit may be for any of approximately 50 different excise taxes. Even taxpayers that exclusively owe taxes on motor fuel are likely to have tax liability for a combination of gasoline, diesel, kerosene, gasohol and possibly various alternative fuels. These fuels are taxed at different rates and distributed in different proportions across four different accounts: the two accounts of the Highway Trust Fund, the Leaking Underground Storage Tank Trust Fund, and the General Fund.

In the absence of sufficient information from the taxpayer regarding the composition of excise tax deposits, tax receipts appropriated to the Highway Trust Fund are estimated as called for in Section 9601 of the Internal Revenue Code. Thus on a semimonthly basis the Office of Tax Analysis allocates incoming excise tax receipts based on historical liability shares as an estimate of the amounts appropriated to the Highway Trust Fund.

Taxpayers report their excise tax liability quarterly on Form 720, which is due one month following the close of the quarter. On the Form 720 taxpayers itemize their liability, for example reporting the number of gallons of each type of fuel and the tax due, and claims of nontaxable use of the fuel. Any balance due or overpayment is settled at the time the Form 720 is filed. Taxpayers report liability for the heavy vehicle use tax on Form 2290. For vehicles in use in July the return is due by August 31; otherwise it is due by the end of the month following the month the vehicle is first used. In general, payment must be paid in full with the return or in quarterly installments.

In conjunction with taxpayer payment records, the Internal Revenue Service (IRS) uses the Form 720 and Form 2290 returns to calculate the Highway Trust Fund Certification of taxes collected for the quarter. After processing the excise tax return the IRS compares the reported tax liability with the deposits received from each taxpayer. In cases where taxpayers have reported tax liability exceeding their deposits, deposits are allocated based on their prorated reported liability to assure that certified amounts equal tax collections. On the quarterly certification IRS reports the total prorated liability for the quarter. In order to allow time for late filing by taxpayers, amended returns, or adjustments from examinations, the certification is issued approximately four and a half months following the due date of the return. The certified amount is then compared to the amounts transferred as estimated. Reconciling adjustments are made to the trust fund accounts for any differences between the certified amounts and the amounts previously transferred.

In the past, the end of year financial statements for the Highway Trust Fund were not finalized until February, hence the final statements reflected three quarters of certified receipts and one quarter of estimates. The reconciling adjustment for the final quarter of the year would be reflected in the subsequent fiscal year. Beginning in FY 2002 Treasury will finalize the end of year financial statements in November, six weeks following the close of the fiscal year. As a result, beginning this year the end of year financial statements will reflect two quarters of actual receipts and two quarters of estimated receipts.

Forecast of Future Excise Tax Receipts

Looking forward, the Administration projects steady growth in highway-related excise tax receipts. Net receipts in FY 2003 are projected to be 6.2 percent higher than FY 2001 and 2.9 percent higher than FY 2002. Average annual growth is forecast to be more than 3 percent per year over the remainder of the budget period. The FY 2003 Budget forecasts a faster long-run growth in receipts than last year's Budget; however, this faster rate of growth is relative to a smaller base, so the forecasted levels are lower than previously projected. In the current budget,

the Administration forecasts net Highway Account excise tax receipts to be \$28.57 billion in FY 2003.

During the first five years of the forecast period, gallons of gasoline and gasohol fuels are projected to grow at an average of 2.3 percent per year. The consumption of gasohol fuels grows faster than gasoline consumption due to the increasing reliance on ethanol as an oxygenate to meet clean air requirements. Because of the difference in the amount per gallon dedicated to the Highway Account, total gasoline and gasohol receipts grow at about 2 percent per year during the first five years of the forecast, which is slower than the rate of growth of fuel consumption.

While Gasoline and Diesel tax receipts are entirely dedicated to the Highway and Leaking Underground Storage Tank Trust Funds, some 2.5 cents per gallon of Gasohol receipts are retained in the General Fund. This general revenue from gasohol fuels is estimated to be almost \$600 million in FY 2003 and, if the taxes were extended, almost \$800 million in FY 2012. In addition, it is estimated that in FY 2003 approximately \$1.1 billion in excise tax receipts will be forgone due to the excise tax exemption for ethanol fuels; in FY 2012 the excise tax exemption is estimated to reduce Highway Trust Fund receipts by \$1.5 billion.³

The truck related excise tax receipts are projected to grow quickly as the economy recovers. For FY 2003 compared to FY 2001, receipts from the retail tax on trucks are projected to grow 22.1 percent and tire tax receipts are projected to grow by 10.6 percent. Between FY 2003 and FY 2002 receipts from the retail tax on trucks are projected to grow 15.6 percent and tire tax receipts are projected to grow 6.5 percent. This growth reflects the recovery of the heavy truck market and more generally increased investment in equipment. Due to continued weakness in the manufacturing sector of the economy, diesel fuel receipts are forecast to decline slightly between FY 2001 and FY 2002 before resuming growth averaging more than 3.5 percent per year.

In summary, the Administration's forecast of highway-related excise taxes reflects the most recent tax collection and liability data available, and the Administration's economic forecast. The data reflect the weakness in the economy during 2000 and 2001. The forecast for future years is based on the assumption that the economic downturn would end in early 2002 and a strong recovery would be underway later in the year.

Administrative and Compliance Difficulties with Highway Excise Taxes

Maintaining the flow of receipts into the Highway Trust Fund requires continuing efforts to secure better tax compliance. Over the last decade there have been three major compliance success stories. Moving the point of taxation for motor fuels to the terminal rack significantly reduced opportunities for tax evasion, some of it carried out on a multi-million dollar scale by sophisticated criminal organizations. Requiring diesel fuel, home heating oil and other diesel substitutes to be dyed red if sold tax-free eliminated another source of evasion. The third has

³ This is an updated Tax Expenditure estimate reflecting the ethanol consumption in the current forecast. The Tax Expenditure estimate does not consider changes in the use of fuel that may accompany a change in tax policy. For further detail on Tax Expenditures, see Chapter 6 of the Analytical Perspectives volume of the Fiscal Year 2003 Budget.

been the taxation of undyed kerosene on the same basis as the regular diesel fuel with which it is often mixed.

Combating fuel tax evasion occurring outside the main distribution network is a continuing effort of the IRS in cooperation with State tax authorities. Untaxed kerosene intended to be used as aviation fuel, "transmix" taken out of pipelines, waste vegetable oils, used dry-cleaning fluids, and other chemicals may be mixed with diesel fuel and find their way into the fuel tanks of trucks on the road. New initiatives are under way to combat this form of evasion. One is a detailed, computerized information system developed in cooperation with the petroleum industry and the States that will allow all fuels to be tracked from the refinery gate all the way through the distribution system. Another is "fuel fingerprinting," a technique that tests samples taken from retail stations for adulteration or for a mismatch with samples taken from the terminal racks that normally supply those stations. These continuing efforts are supported in part by a small appropriation from the Highway Trust Fund of moneys used specifically for compliance efforts.

The annual use tax involves all owners of heavy highway vehicles and imposes significant compliance burdens on taxpayers, the IRS, and State agencies. Some vehicle owners evade full compliance by paying the first quarter's tax but not subsequent installments.

The retail truck tax is particularly difficult to administer and compliance is particularly difficult for truck dealers and others. A factual finding must be made to determine if the truck is "heavy," i.e., whether the truck chassis or trailer body is suitable for use with a vehicle that has a gross vehicle weight in excess of 33,000 pounds. The determination of whether a truck has been remanufactured (and is therefore subject to tax) or has been repaired can be involved and may be confusing to the taxpayer. In some cases the distinction between a highway vehicle and a vehicle intended for off-highway use is not clear. There are a number of exemptions for particular types of trucks and installed equipment that are a continuing source of controversy between taxpayers and the IRS.

The Treasury Department expects to announce proposals to both simplify and improve compliance with the excise taxes that support the Highway Trust Fund as part of its ongoing simplification project.

Conclusion

I appreciate this opportunity to describe revenue issues related to the Highway Trust Fund and present our current forecast to you.

TABLE 1
ACTUAL AND FORECAST EXCISE TAX RECEIPTS TO THE HIGHWAY ACCOUNT OF THE HIGHWAY TRUST FUND

Highway Account	Actual 2000	Actual 2001	Forecast 2002	Forecast 2003	Forecast 2004	Forecast 2005	Forecast 2006	Forecast 2007	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011	Forecast 2012
[millions of dollars, fiscal years]													
Gross Receipts													
Gasoline	17,969	16,922	17,165	17,465	17,707	17,888	18,240	18,571	18,846	19,109	19,397	19,692	19,995
Gasohol fuels	1,293	1,519	1,696	1,850	2,009	2,198	2,305	2,364	2,411	2,465	2,513	2,568	2,607
Diesel and other fuels	7,427	7,158	7,079	7,219	7,491	7,892	8,173	8,487	8,810	9,157	9,503	9,904	10,330
Retail tax on trucks	3,321	1,489	1,572	1,818	2,153	2,504	2,834	3,103	3,343	3,577	3,843	4,168	4,522
Highway-type tires	442	343	356	379	400	419	435	450	464	477	490	502	514
Heavy vehicle use tax	921	610	891	938	966	1,035	1,082	1,129	1,178	1,229	1,282	1,337	1,395
Gross Highway Account Receipts	31,374	28,040	28,759	29,669	30,746	31,936	33,069	34,104	35,052	36,014	37,028	38,181	39,363
Less Aquatic Resources	209	215	251	256	271	277	284	289	294	299	306	314	320
Net Highway Account Receipts	31,165	27,825	28,508	29,413	30,475	31,659	32,785	33,815	34,758	35,715	36,722	37,847	39,043
Less HA Refunds	831	925	650	843	872	910	941	973	1,006	1,039	1,073	1,112	1,154
Net Highway Account Receipts	30,334	26,900	27,858	28,570	29,603	30,749	31,844	32,842	33,752	34,676	35,649	36,735	37,889
Year-to-Year Changes													
Gasoline		-1,047	243	300	242	181	352	331	275	263	288	295	303
Gasohol fuels		226	177	154	159	189	107	59	47	54	48	45	49
Diesel and other fuels		-269	-79	140	272	401	281	314	323	347	346	401	426
Retail tax on trucks		-1,832	83	246	335	351	330	269	240	234	266	325	354
Highway-type tires		-99	13	23	21	19	16	15	14	13	13	12	12
Heavy vehicle use tax		-312	281	47	46	49	47	47	49	51	53	55	58
Gross Highway Account Receipts		-3,334	719	910	1,077	1,190	1,133	1,035	948	962	1,014	1,133	1,202
Less Aquatic Resources		7	36	5	5	6	7	5	5	5	7	8	6
Net Highway Account Receipts		-3,340	683	905	1,062	1,184	1,126	1,030	943	957	1,007	1,125	1,196
Less HA Refunds		94	-95	13	29	38	31	32	33	33	34	39	42
Net Highway Account Receipts		-3,435	778	882	1,033	1,146	1,095	998	910	924	973	1,086	1,154
Year-to-Year Percentage Changes													
Gasoline		-5.8%	1.4%	1.7%	1.4%	1.0%	2.0%	1.8%	1.5%	1.4%	1.5%	1.5%	1.5%
Gasohol fuels		17.5%	11.7%	9.1%	8.6%	9.4%	4.9%	2.6%	2.0%	2.2%	1.9%	1.8%	1.9%
Diesel and other fuels		-3.6%	-1.1%	2.0%	3.8%	5.4%	3.6%	3.8%	3.8%	3.8%	3.9%	4.2%	4.3%
Retail tax on trucks		-55.2%	5.6%	15.6%	18.4%	16.3%	13.2%	9.5%	7.7%	7.0%	7.4%	8.5%	8.5%
Highway-type tires		-22.5%	3.9%	6.5%	5.5%	4.8%	3.8%	3.4%	3.1%	2.8%	2.7%	2.4%	2.4%
Heavy vehicle use tax		-33.8%	46.2%	5.3%	5.1%	5.0%	4.5%	4.3%	4.3%	4.3%	4.3%	4.3%	4.3%
Gross Highway Account Receipts		-10.6%	2.6%	3.2%	3.6%	3.9%	3.5%	3.1%	2.8%	2.8%	2.8%	3.1%	3.1%
Less Aquatic Resources		3.1%	16.6%	2.0%	5.9%	2.2%	2.5%	1.8%	1.7%	1.7%	2.3%	2.6%	1.9%
Net Highway Account Receipts		-10.7%	2.5%	3.2%	3.6%	3.9%	3.5%	3.1%	2.8%	2.8%	2.8%	3.1%	3.2%
Less HA Refunds		11.4%	-10.3%	1.6%	3.4%	4.4%	3.6%	3.4%	3.4%	3.3%	3.3%	3.6%	3.8%
Net Highway Account Receipts		-11.3%	2.9%	3.2%	3.6%	3.9%	3.6%	3.1%	2.8%	2.7%	2.8%	3.0%	3.1%

Note: The FY 2000 and FY2001 figures are based on the end-of-year Highway Account Income Statement reported by the Bureau of Public Debt. The FY 2002 through FY 2012 figures are forecasts made by the Office of Tax Analysis, Department of the Treasury for the FY 2003 Budget.

**Questions submitted for the record for testimony of
Andrew B. Lyon
Deputy Assistant Secretary for Tax Analysis
U.S. Department of Treasury
before the Senate Finance Committee
May 9, 2002**

Responses to Questions for the Record from Senator Grassley

1. Approximately how many taxpayers pay fuel excise taxes?

Answer: Approximately 4,000 taxpayers.

2. Out of the \$34 billion paid in fuel excise taxes how many of those taxpayers made up approximately 90 percent of those deposits?

Answer: Of the 4,000 taxpayers making fuel tax excise payments, the top 20 to 25 taxpayers pay about 90% of the fuel taxes dedicated to the Highway Trust Fund.

3. Overall, how do you feel about compliance with the fuel excise tax system?

Answer: Compliance is very difficult to measure. We believe that while compliance as a percent of total fuel consumption is high there remains a significant amount of fuel tax evasion particularly with respect to diesel fuel. A representative of the IRS provided more detail on this matter in his testimony before this Committee on July 17th.

4. Could we reduce the evasion of fuel excise taxes?

Answer: Yes, reducing evasion is possible but not easy. Reducing evasion is a continuing responsibility of the IRS. Careful decisions are required regarding the best use of scarce IRS compliance resources and burdens placed on compliant taxpayers. This was a topic covered in the IRS testimony presented to this Committee on July 17th.

Some problems of evasion can best be addressed by revising excise tax regulations, such as the recently proposed regulations relating to the definition of diesel fuel and the persons liable for remitting the tax on blended taxable fuel. The Treasury will work with the Congress in identifying and enacting legislative changes that will reduce opportunities for evasion.

5. Obviously, the sooner the tax return information can be shared with Treasury, the more accurate the estimates. How far is Treasury from "real time" reporting, or electronic filing of the Form 720?

Answer: Taxpayers currently have the opportunity to provide detailed information at the time of deposit via the Electronic Federal Tax Payment System. Most taxpayers do not do so voluntarily and taxpayers have indicated that there would be a substantial burden to do so at this time. Hence "real time" reporting of excise tax information is several years away.

Responses to Questions for the Record from Senator Nickles

1. *The Joint Committee on Taxation recommended eliminating or reducing the number of separate taxes imposed to finance the Highway Trust Fund, while adjusting the remaining taxes to maintain adequate revenue, in order to reduce the substantial compliance burden for what results in very little revenue. For example, the Joint Committee discussed eliminating the non-fuel taxes while raising the fuel taxes an offsetting amount to remove the compliance burden on the non-fuel taxes. They also discussed consolidating the non-fuel highway trust fund excise taxes, but mentioned that this may upset the competitive balance in the industry. Since efforts to repeal the tire tax in 1997 failed because of concerns that it would change the competitive balance between new tires and retreads, which aren't taxes, I would agree with them. Does Treasury have a view on which route to take on addressing reducing this compliance burden?*

Answer: Treasury recognizes the need for simplification in this area as well as an appropriate balance of highway tax burden among various users. Our ongoing simplification project is expected to provide some constructive suggestions for reducing the burdens of the current taxes.

2. *In my bill, S. 594, I'm attempting to simplify the compliance with the tax on heavy truck tires on a revenue neutral basis. The tax has been based on tire weight for decades, which forces tire manufacturers to weight sample batches of every tire they make, keep track of that weight for each tire, and then determine and collect a tax based on that weight. Then the IRS audits each step. Instead I propose to tax the tires on load carrying capacity, which approximates their weight and their impact on the roads. Moreover, DOT requires they stamp the load rating on the side of highway tires or pay a fine, so it's easy to determine whether a tire is taxable and how much should be paid. Can you tell me if the 8 cents per 10 lbs of load carrying capacity for tires rated over 3500 lbs would generate the same amount of revenue, which was \$436 million in FY00. One subsequent study says it may be 9 cents instead. Would Treasury support using this method to simplify compliance with the tax?*

Answer: As mentioned in my testimony, the Treasury tax simplification project is ongoing. However, load rating of a tire appears to be simpler base for the tax on tires than the existing weight based system.

3. *It's been called to my attention that some shippers still use bias ply tires, especially for moving container cargo, and that such tires are currently taxed as about half the rate of radials. Can you tell me how much the tax of 8 cents per 10 lbs of load carrying capacity would have to be adjusted to keep bias ply tires taxes from going up?*

Answer: We have not evaluated an alternative basis for the tire tax nor do we have data regarding the production or importation of bias ply tires of different weights and load bearing capacities so we can not answer this question specifically. However it is likely that moving to an alternative tax base on a revenue neutral basis will result in some tires having a higher tax burden than before and other tires a lower tax. Using load carrying capacity would provide greater transparency and be more closely tied to highway use and thus be viewed by many as a "fairer" basis of taxation.

Responses to Questions for the Record from Senator Inhofe

Current law requires that the owner of a truck weighing 55,000 pounds or more is required to pay an annual Heavy Vehicle Use Tax (HVUT) on that truck. This tax can be paid in one lump sum or in quarterly installments. However, it is my understanding that if the owner sells the truck at any time during the taxable year, that taxpayer is still responsible for paying the full year's HVUT on the vehicle, even if that vehicle is no longer owned by that person. This requirement could force a taxpayer to make quarterly tax payments on a truck that was sold by the tax payer eight months earlier, which goes against the very concept of "use" taxes.

I would like to know if you would support pro-rating the HVUT to require that a taxpayer only pay the portion of the annual use tax on a truck that corresponds to the portion of the year that truck is actually owed by the taxpayer? Shouldn't the purchaser of a truck be required to pay the HVUT on that vehicle for the remaining portion of the taxable year? Furthermore, under this scenario, should it be the responsibility of the taxpayer that sold the vehicle to enforce the tax payment obligations on the purchaser, or is it the responsibility of the IRS to enforce that tax?

Answer: The regulations with respect to the Highway Use Tax at §41.4481-2 make it clear that the person liable for the tax in a taxable period (i.e., a year beginning on July 1) is the person in whose name the vehicle is registered at the time of first use during the period. If the vehicle is sold to another person during that period the buyer is only liable for the tax to the extent that the seller did not pay (perhaps because the seller paid on the quarterly basis) and for the remaining portion of the year. If the buyer pays that tax the seller is no longer liable. Presumably the price that the vehicle sold for includes the remaining value of the use tax that has been paid on the truck. The HVUT is an extremely difficult tax to administer due to the large numbers of taxpayers and the cooperation required from State registration agencies. Changing the treatment of vehicles whose ownership changes during a taxable period would add further administrative difficulties.

Responses to Questions for the Record from Senator Jeffords

I have been an advocate for annual funding to the states under the Federal-aid Highway program at the maximum level sustainable by the Highway Trust Fund. I define 'sustainable' as the level of outlays that can be made while still maintaining a prudent cash balance in the Trust Fund. Some have suggested that the Trust Fund should be spent down to zero. Please comment on the need for a cash balance in the Highway Trust Fund and the appropriate level of such a balance.

Answer: Because the cash needs of the Trust Fund are dictated largely by obligation and outlay rates, the Department of Transportation, which closely monitors Trust Fund spending, would have the appropriate expertise to respond to this question.

Prepared Statement of the Hon. Craig Thomas

I would like to thank Chairman Baucus and Ranking Member Grassley for holding today's hearing regarding the status of the Highway Trust Fund. This issue is very important to me because as a member of the Environment and Public Works Committee, I helped craft the Transportation Equity Act for the 21st Century (TEA-21).

As many of my colleagues know, the TEA-21 bill significantly boosted funding for federal highway needs. As a result, folks across the country have reaped the benefits of the changes to our country's surface transportation system. More importantly, TEA-21 has provided state and local governments with much greater control and flexibility in their use of federal funds.

I look forward to hearing from today's panelists who will touch upon the funding mechanisms that the Highway Trust Fund relies upon. In particular, how Congress can address the looming problem with this year's negative Revenue Aligned Budget Authority (RABA). I am also interested to hear ideas from our panelists regarding possible new funding streams for the Highway Trust Fund.

Lastly, the tax disparity between gasoline and ethanol blended "gasohol" is something that I believe this committee needs to review. As a member of the Senate Energy and Natural Resources Committee, the discrepancy between these fuels is causing great debate not only in the context of the Highway Trust Fund, but in terms of our nation's energy policy. I am anxious to hear our panelists testimony on the current tax disparity and its subsequent impact on the Highway Trust Fund. Moreover, I would like to know what they believe is the best answer to this shortfall. I noted in Ms. Hecker's prepared statement, "that the Highway Account did not receive about \$6.01 billion from Fiscal Years 1998 through 2001 due to gasohol's partial tax exemption and General Fund transfer." These are serious issues that must be addressed.

As my colleagues know, the Senate passed energy bill includes a mandate of 5 billion gallons of ethanol by 2012. As a result of this mandate, and the increasing reliance on gasohol, I believe this committee needs to look at the tax preference that ethanol currently receives and determine whether or not that preference should be continued in its current form.

In closing, I want my colleagues on the Finance Committee to know that I look forward to working with them on funding matters associated with the Highway Trust Fund.