JANUARY
2012

policy matters

california senate OFFICE OF RESEARCH

# Federal Transportation Funding: How Does It Work and What Will the New Transportation Act Mean for California?

Federal funds allotted to states for transportation projects are up for renewal by Congress early this year: March 31, 2012, is the deadline. What California stands to gain—or lose—is significant. Congress will either temporarily extend existing funding levels for the ninth time since 2009, or write a new legislative act. While states are pushing for a new act that will provide long-term transportation funding guarantees, the debate in Congress over revenue sources poses a risk: a new act could provide less funding than states currently receive.

**Taxes at the Pump: Federal Gas Taxes Have Not Increased Since 1993**

The federal excise tax on gasoline—18.4 cents per gallon—is the primary funding source for federal transportation programs. This tax helps pay for critical transportation projects in California and the rest of the nation, but aging and deteriorating highways and byways require more funding than resources now provide.

Debate over the reauthorization of federal transportation programs is complex and controversial, but the final outcome is critical to California and the health of its roads, highways, tunnels, bridges, and transit systems.

## The Funding Process: Step by Step

Like many federal programs, federal transportation programs receive funding through legislative acts. Transportation acts authorize programs and funding for a specific period, usually five or six years. These acts establish programs and outline the funding, the distribution of funds, the period during which the funds may be spent, and eligible activities.

Congress generally funds federal programs through "appropriated budget authority," but most transportation programs operate through "contract authority." Under appropriated budget authority, the act authorizes a maximum amount of funds, but the federal government may not actually distribute the funds until Congress passes an appropriations act. Under contract authority, the act itself authorizes both the funds and the distribution. The rationale for using contract authority: most major transportation projects are multiyear endeavors that state and local governments are reluctant to undertake without knowing the federal funds will indeed be available.

**California's Transportation System Shows Its Age**

According to the California Transportation Commission, just the maintenance and preservation of the state's existing roads and highways will cost more than $300 billion over the next 10 years. Where will the money come from?

Even after an authorization act is passed, the Federal Highway Administration (FHWA) does not simply distribute funds to states. Instead, FHWA notifies states of the available funds, obligates (commits) funds for approved projects, and makes payments as costs are incurred. Generally, this goes as follows:

- a contractor completes work and submits a bill to the state transportation department;
- the department submits a claim to FHWA;
- FHWA reviews and certifies the claim and submits it to the U.S. Treasury;
- the U.S. Treasury electronically transfers the funds to the state;
- the state pays the contractor (the electronically transferred federal funds constitute reimbursement to the state).

In most cases, the federal share of transportation project costs is 80 percent, and states are required to provide matching funds. Funding for most federal transportation programs is authorized for a period of four years; if a state fails to obligate a particular year's funding within the designated time frame, the authorization expires.

As noted, FHWA only obligates funds for approved projects. These projects must be included in the current federally approved Federal Transportation Improvement Program/Federal Statewide Transportation Improvement Program. If a project or project phase commences prior to approval, it is deemed ineligible for federal reimbursement.

The California Department of Transportation (Caltrans) works with FHWA to oversee all funded projects; if a project fails to comply with federal requirements, Caltrans may revoke the funding.

## Does California Get Its Fair Share of Federal Transportation Funding?

For many years, California and other states have debated whether they get a "fair" rate of return on the dollars they contribute to the federal Highway Trust Fund (HTF).

The Transportation Equity Act for the 21st Century (TEA-21) included a "minimum guarantee," which ensured each state would receive at least 90.5 percent of its share of HTF contributions. The Equity Bonus Program—under the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU)—guaranteed states an initial return of at least 90.5 percent (which gradually increased to 92 percent in 2009).

Nearly every state received Equity Bonus funding each year from 2005 to 2009; California's cumulative share was equivalent to a 21.7 percent boost over its base funding.

Depending on the calculation method, a state may be considered a "donor" state (a state that contributes more in federal highway revenues to the HTF than it receives) or a "donee" state (a state that receives more from the HTF than it contributes).

For example, using same-year comparison data, California's rate of return per dollar contributed to the HTF between 2005 and 2009 was $1.19, making California a *donee* state. But under a relative-share calculation method—comparing the amount a state receives relative to other states—California's rate of return was only 91 percent, making it a *donor* state.

Regardless, the U.S. Government Accountability Office points out that due to General Fund augmentations to the HTF, every state was a donee state during the SAFETEA-LU period; in fiscal year 2009, states collectively contributed $30.1 billion in highway user fees into the HTF, but received $42.4 billion. During the SAFETEA-LU period, California paid approximately $16 billion to the HTF and received (depending on the calculation method applied) between $16 billion and $19 billion.

## The "Teas"

In the 1990s Congress began to expand the focus of federal transportation funding beyond the interstate highway system, taking a more intermodal approach of linking the highway, rail, air, and marine transportation systems.

The Intermodal Surface Transportation Efficiency Act of 1991, known as ISTEA (pronounced *ice-tee*), was signed by President George H.W. Bush on December 18, 1991. This legislation provided about $155 billion for highways, highway safety, and transit programs—California's share was approximately $13 billion—and expired on September 30, 1997. Rather than passing a new act, Congress extended the funding authorization while it debated funding issues internally and with the administration.

On June 9, 1998, President Bill Clinton signed a new transportation funding act, the Transportation Equity Act for the 21st Century, known as TEA-21 (*tee-21*). This legislation authorized $218 billion—a 40 percent increase over the prior act—for federal transportation programs for the years 1998–2003; California's share was approximately $20 billion. TEA-21 expired on September 30, 2003, and was extended by Congress numerous times.

On August 10, 2005, President George W. Bush signed the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, known as SAFETEA-LU (*safety-loo*). This legislation included a greater emphasis on safety programs and provided about $244.1 billion to states from 2005–2009, including approximately $23 billion for California. SAFETEA-LU provided $52.6 billion for federal transit programs, a 46 percent increase over TEA-21. The act expired on September 30, 2009, and has since been extended by Congress eight times. SAFETEA-LU's current extension expires March 31, 2012.

## Where Does the Money Come From?

Federal transportation programs are funded by the Highway Trust Fund (HTF). Congress created the HTF in 1956 to help finance the interstate highway program.

The HTF was intended to be a user-supported fund: taxes dedicated to the HTF were paid by highway users, and HTF revenues helped finance highways. Today, the HTF is supported primarily by excise taxes collected on motor fuels and truck-related taxes (see "How Federal Transportation Programs Are Funded" on the opposite page).

HTF's primary funding source is the motor fuels tax, commonly known as the federal gas tax. This tax of 18.4 cents per gallon has not been increased by Congress since 1993. As noted by the Council of State Governments: "The buying power of fuel taxes has been eroded by inflation, and Americans are paying less fuel taxes, due both to fuel efficiency improvements on automobiles and cutbacks on driving, as gas prices have increased in recent years."

As a result, HTF revenues have declined, forcing Congress to augment the fund with approximately $30 billion in General Fund revenues since 2008 to meet project obligations. Like the SAFETEA-LU act, the federal gas tax had expired, so Congress extended it to March 31, 2012.

## How Federal Transportation Programs Are Funded


| TAX TYPE | TAX RATE |
|---|---|
| **Gasoline and Gasohol** | 18.4 cents per gallon |
| **Diesel** | 24.4 cents per gallon |
| **Liquefied Petroleum Gas** | 18.3 cents per gallon |
| **Liquefied Natural Gas** | 24.3 cents per gallon |
| **M85 (from Natural Gas)** | 9.25 cents per gallon |
| **Compressed Natural Gas** | 18.3 cents per 126.67 cubic feet |
| **Tires** | 9.45 cents for each 10 pounds of maximum rated load capacity over 3,500 pounds |
| **Truck and Trailer Sales** | 12 percent of retailer's sale price for tractors and trucks over 33,000 pounds gross vehicle weight and trailers over 26,000 pounds gross vehicle weight |
| **Heavy Vehicle Use** | Annual tax for trucks 55,000 pounds and over gross vehicle weight: $100 plus $22 for each 1,000 pounds (or fraction thereof) in excess of 55,000 pounds. Maximum tax: $550 |

Source: Federal Highway Administration (April 2011)

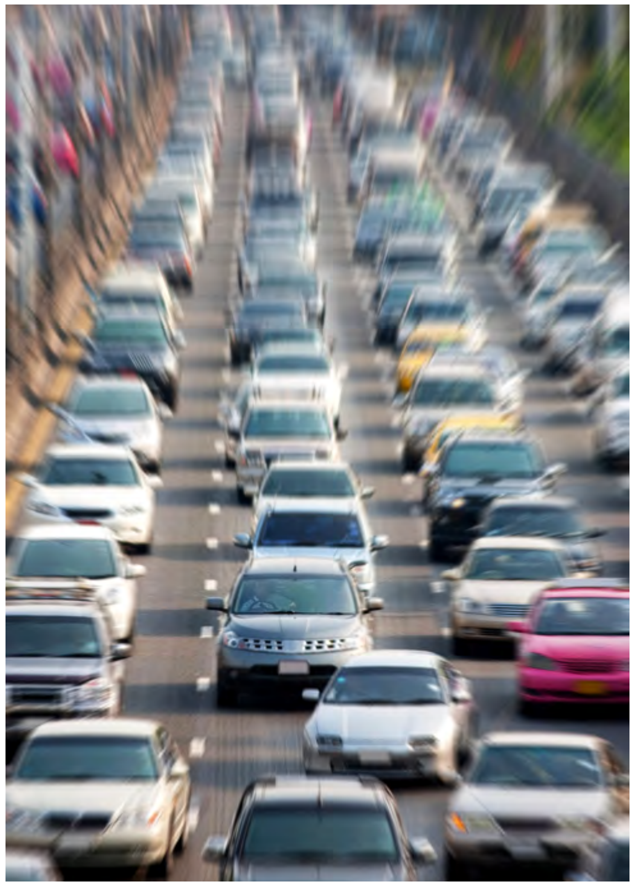
## Where Does the Money Go?

The HTF is divided into two accounts: the Highway Account, and the Mass Transit Account. These accounts provide funding for programs authorized by SAFETEA-LU.

More than 80 percent of fuel-tax revenues are deposited into the Highway Account.

As noted, the federal government obligates funds to states for approved transportation projects. Most program funding is determined by complex formulas based on factors such as the amount of taxes California highway users pay relative to highway users in other states (see “Does California Get Its Fair Share of Federal Transportation Funding?” on page 3).

Three-quarters of California’s SAFETEA-LU funding was designated for the state’s highway programs, about one-fifth for transit programs (such as the Transportation for Elderly Persons and Persons With Disabilities program), and the remainder (about 2 percent) for safety programs (such as the Safe Routes to School program).



**California Relies on the Federal Government for Transportation Funds, But Funding After March 2012 Is Uncertain**

California is projected to receive $30.9 billion in federal transportation funds over the next decade—13 percent of the state’s transportation funding. Yet if Congress fails to approve another extension of the transportation act or pass a more generous act, the state stands to lose billions of urgently needed transportation dollars.

## What Is the Debate About?

Reauthorization generates significant policy debate because it provides Congress the opportunity to re-examine and modify existing transportation programs and create new programs. The most contentious issue in the current reauthorization debate is funding.

The U.S. Government Accountability Office explains that General Fund augmentations to the HTF have “changed the ‘user pay’ principle and complicated the link between highway taxes and highway funding.” Moreover, given current fiscal conditions, it is unlikely Congress will continue to shore up the HTF with General Fund revenues. Yet the consensus is the gas tax no longer sufficiently funds program needs, which means Congress must either significantly cut programs or find another method of ensuring the HTF’s solvency.

Congress is considering many funding alternatives, such as toll roads, mileage-based user fees, public-private partnerships, and gas-tax increases. Some experts argue increasing user fees could help increase revenues (and perhaps even reduce the use of various roads, as some drivers may not want to pay a toll to drive on them).

In addition to funding, Congress is debating many transportation policy issues, including:

- **National Infrastructure Bank.** President Barack Obama has proposed creating a national infrastructure bank, which would fund transportation and other projects; some Congress members prefer to strengthen state infrastructure banks instead.
- **Transportation Infrastructure Finance and Innovation Act (TIFIA) Program.** Congress also is discussing whether to expand TIFIA (*TIFF-ee-uh*), which helps states leverage federal funds by providing federal credit assistance to "nationally or regionally significant" transportation projects.
- **Transportation Enhancement (TE).** A major issue in the fall 2011 extension debate was whether the TE program should be expanded. This program includes "enhancements," such as providing landscaping and other scenic beautification, funding scenic or historic highway programs, establishing transportation museums, and creating facilities for pedestrians and bicyclists. Some argue the program should be amended to give states the flexibility to use TE funds for more "basic" needs, such as repaving roads and repairing bridges.
- **Streamlining.** Congress and stakeholders also are looking at simplifying the transportation funding system. With more than 100 programs, each with its own set of requirements, the consensus is the system has grown overly complex and unwieldy.

For states, the heart of the transportation reauthorization debate is certainty. Short-term extensions pose a constant threat: if Congress fails to pass another extension or enact a new authorization, federal funds to states will cease. As noted by the nonpartisan California Legislative Analyst's Office, most transportation projects are funded from multiple sources; if one source evaporates, states must find replacement funds. This is a daunting task during difficult fiscal times and could cause costly project delays or even shutdowns.

A California Transportation Commission report published in November 2011 estimates the total cost of preservation, management, and expansion of California's transportation systems from 2011–2020 at approximately $538.1 billion, far outstripping the estimated $242.4 billion in available revenues. The estimated available revenues include $30.9 billion in federal transportation funds over this 10-year period—nearly 13 percent of the total funding. Losing these federal funds could make California's transportation funding deficit insurmountable.


**Written by Erin Riches.** The California Senate Office of Research is a nonpartisan office charged with serving the research needs of the California State Senate and assisting Senate members and committees with the development of effective public policy. It was established by the Senate Rules Committee in 1969. For more information and copies of this report, please visit **www.sen.ca.gov/sor** or call **(916) 651-1500.**