

An hourglass-shaped graphic with a globe in the top bulb and another globe in the bottom bulb. The hourglass is light blue and has a dark blue top and bottom. The globe in the top bulb is dark blue, and the globe in the bottom bulb is light blue. The hourglass is centered on the page.

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Highway Finance: RABA's Double-edged Sword

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Highway Finance: RABA's Double-edged Sword

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Summary

The debate over a possible reduction in federal highway program spending during FY2003 has ended. Congress has chosen to overrule provisions of law that would have reduced the FY2003 spending level to \$23.2 billion, and has instead settled on \$31.8 billion, the same as the FY2002 level. In early 2002, it appeared that a major reduction in highway program spending was in the offing. An Office of Management and Budget calculation in the President's budget indicated that the RABA adjustment for FY2003 would be negative. The Administration and Congress were not proposing a cutback. Rather a complex financing mechanism known as Revenue Aligned Budget Authority (RABA) was proving the famous law of unintended consequences. Predictions made at the time RABA was created by the Transportation Equity Act for the 21st Century as amended (TEA-21)(P.L. 105-178 & P.L. 105-206) saw it as an ever growing source of funding for the highway program, even though RABA was created with the possibility of a downward adjustment. RABA provided the highway program with almost \$9 billion in additional financing during the years FY2000 through FY2002. Congressional action in the 2nd Session of the 107th Congress precluded this downward adjustment, at least in part, and the Consolidated Appropriations Resolution, 2003 (P.L. 108-7) guaranteed that funding would remain at the FY2002 level. This report will not be updated.

A little understood feature of TEA-21 became a significant policy issue in the 2nd Session of the 107th Congress. The Federal Highway Administration (FHWA), State Departments of Transportation, and localities throughout the United States had become used to the idea that the federal-aid highway program obligation level would increase every year as a result of additional funds provided by RABA. The possibility that RABA could result in a negative adjustment to the funding level of the highway program had been largely forgotten over the previous 5 years. In fact, the RABA adjustment for FY2003, if it had been applied in accordance with TEA-21 provisions, would have required a reduction in the federal highway programs guaranteed obligation limitation by \$4.369 billion, and a year-over-year adjustment from FY2002 of a negative \$8.6 billion.

The negative RABA adjustment would have resulted in a 27% decline in new highway contracts (obligations) in FY2003 when compared with FY2002. According to estimates by the highway construction industry this would have translated into a serious reduction in construction nationwide with a concomitant loss of some 295,000 jobs.¹ While not all estimates saw the situation in such negative terms, there was no doubt that an \$8.6 billion change in highway spending would have had far reaching consequences for the industry.

This was a problem that wasn't supposed to occur. The concept behind RABA expected growth and saw a so-called "negative RABA" as only a small possibility.

A downward adjustment of the obligation limitation and authorizations could also occur, but this is improbable given the conservative receipt estimates used to set the guaranteed spending levels set in TEA-21.²

Faced with the unexpected, Congress and the Administration had to decide whether to let the RABA adjustment stand or whether to modify the RABA result in some way. Congress has now considered the issue and decided to overrule the RABA adjustment and retain spending at the FY2002 level.

RABA Origins

The Transportation Equity Act for the 21st Century (TEA-21) changed the budget framework for the federal highway and transit programs. It did this in two ways. First, by creating new budget categories, and second, by setting statutory limitations on obligations. The Act amended the Balanced Budget and Emergency Deficit Control Act of 1985 to create two new budget categories: highways and mass transit. The Act further amended the budget process by creating a statutory level for the limitation on obligations in each fiscal year from FY1999 to FY2003.³ Finally, TEA-21 provided a mechanism, RABA, to adjust the amounts available in the highway account to correspond with increased or decreased receipts in trust fund dedicated tax revenues. The transit account was not included in the RABA process.

The net effect of the creation of these budget categories is a predetermined level of funding for core highway programs, which is referred to in TEA-21 as a discretionary spending guarantee or the guaranteed level. These categories are separated from the rest of the discretionary budget in a way that prevents the use of funds assigned to these categories for any other purpose. These so called "firewalls" are viewed, in the TEA-21 context, as guaranteed and/or minimum levels of funding for highway and transit programs. Additional funds above the firewall level can be made available through the annual appropriations process.

¹ [<http://www.transportation.org/aash...fd9e86256b4500776347f?OpenDocument>]

² U.S. Department of Transportation. *Transportation Equity Act for the 21st Century: A Summary*. 1999. p. 3.

³ A limitation on obligations is a restriction on the amount of federal assistance that may be promised (obligated) during a specific time period (fiscal year).

The RABA process provides a link between the trust fund dedicated tax revenues that flow into the highway account and highway spending. This relationship has long been sought by advocates of increased highway spending who have contended that highway user fees should be available only for highway programs.

The RABA Calculation

The Act requires that the Office of Management and Budget (OMB) make an annual evaluation of revenues in the highway account during the year prior to the current fiscal year vis-a-vis predicted levels of revenue cited in TEA-21. This is known as the “look-back” adjustment. The Secretary must then predict revenues vis-a-vis spending authorized within the highway firewall for the new fiscal year. This is the “look-ahead” adjustment. If revenues go up, program spending is increased. Conversely, spending can go down if revenues go down. This mechanism was employed beginning in FY2000.

If a funding adjustment is required, an apportionment change is applied to the core highway programs in each state. In addition, apportionments are made to other allocated federal aid highway and highway safety programs. Finally, funds are reserved on a proportional basis for programs allocated by the Federal Highway Administration (FHWA), such as the federal lands highway program.

At the time TEA-21 was enacted, both the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB) predicted that revenues to the highway account would grow at a level that exceeded the highway authorization provided within the highway firewall. The OMB estimated somewhat more growth than that projected by CBO. By one analysis, looking at a best case scenario (best case from the perspective of an analysis that favors additional spending) the revenue alignment provisions of the bill could have provided as much as \$3.5 billion in additional contract authority for core highway programs during the life of the legislation. We now know that these estimates were dramatically wrong. RABA increases far exceeded these modest expectations during the period FY2000 - FY2002. Also unexpected, however, was the strong downward turn in revenues driving the current debate.

Table1: RABA and TEA-21 Guaranteed Funding

(thousands of dollars)

	FY2000	FY2001	FY2002	FY2003
Highway (obligation limitation)(TEA 21level)	26,245	26,761	27,355	27,811
RABA Adjustment	1,456	3,058	4,543	not applicable
Subtotal subject to obligation. limit	27,701	29,819	31,898	not applicable
Highway (exempt from obligation limit)	739	739	739	739
FHWA Guaranteed Total (after RABA or other Adjustment)	28,440	30,558	32,637	31.8

Source: P.L. 105-178, P.L. 105-206, and [<http://www.fhwa.dot.gov/tea21/>], and P.L. 108-7 for FY2003 guaranteed level

RABA FY2003

What Caused the Negative RABA Adjustment

In a nutshell, the revenue stream for the highway trust fund responded to the direction of the domestic economy. For much of the four decade plus history of the trust fund, Americans almost always drove more each year than the previous year and used more fuel in the process. With the exceptions of the fuel shocks of the 1970s, this pattern has continued, albeit at a slower level, even during recessionary periods.

The boom years of the late 1990s were especially lucrative for the trust fund. As the economy started to slow down in 2000 and 2001 (this equates to the FY2001 look back period used in the FY2003 calculation), trust fund revenues also began to decline. This appears to have been especially true for the trucking industry where new vehicle sales dropped off dramatically. At the same time, gasohol use was increasing, primarily because of its use as a substitute for the controversial additive MTBE. Gasohol is taxed at a lower rate than other highway fuels. So even though automobile use seems to have been fairly constant, revenue to the trust fund decreased, with a concomitant reduction in the look-back factor described in the previous section.

With the Nation in a recession early in 2002, the budget scorekeepers at OMB and Treasury were required to reduce their previous estimates about how well the economy would do in FY2003. As a result, the look-ahead element of the RABA calculation also came up negative. Added together, these factors resulted in the negative \$4.369 billion RABA adjustment included in the President's FY2003 budget proposal.

Potential Effects of a Negative RABA Adjustment

The federal-aid highway program is a slow spending program. This reflects the nature of capital infrastructure projects, which often are multi-year undertakings. The federal-aid program is also slow spending because it is a reimbursable program. That is, states receive no federal payments until they actually accomplish some agreed upon type of work. Funds, therefore, scheduled for obligation in FY2003 might not actually be scored as outlays for several years.

The Administration's FY2003 budget suggested that they viewed the slow spending nature of the program as protection against any serious economic consequences from a reduction in highway obligations;

... in 2003 actual spending on highway construction, including the continuation of prior-year projects, will fall less than three percent from its all-time high in 2002.⁴

The highway construction industry and the states did not share the Administration's view that a one-year drop in highway obligations would have a limited effect. They took the position that the proposed year-over-year reduction would have a dramatic effect and

⁴U.S. Government. *Budget of the United States FY2003, Analytical Perspectives*. February 2002. p. 241.

that there was no guarantee that the program would contract for only one year.⁵ Further, these groups were specifically concerned that a decline in new highway spending would have had a deleterious effect on a recovery from the then ongoing recession.

Congressional Actions

There were several options for dealing with the RABA situation available to Congress. The first of these, and the one tacitly supported by the Bush Administration initially, was to maintain the status quo. From this perspective the downward RABA adjustment is what Congress agreed to allow when it passed TEA21 in 1998. RABA, in this view, had provided significantly more benefit than expected over time, and a down year should be expected from time-to-time. The budget assumptions contained in the President's FY2003 budget submission were predicated on the downward RABA adjustment. Additional spending for highways could have the effect of raising the overall deficit figure in the President's budget, notwithstanding the separate budget category for the highway trust fund and a significant unobligated balance in the trust fund.

An option pursued by some legislators in the 2nd Session of the 107th Congress was legislation that restored FY2003 funding to the guaranteed level contained in TEA-21. H.R. 3694 and S. 1917, the "Highway Funding Restoration Act," were simultaneously introduced on February 7, 2002. These bills were identical. The bills directed that the limitation on obligations for FY2003 be raised to the guaranteed level. In other words they raised spending by \$4.369 billion by drawing from the unexpended balance in the Highway Trust Fund. The bills were introduced by the leadership of the House Committee on Transportation and Infrastructure and the Senate Committee on Environment and Public Works respectively. A majority of both the House and Senate signed on as cosponsors of this legislation. An amended version of H.R. 3694 was reported out of the House Committee on Transportation and Infrastructure on May 1st. S. 1917 as reported to the Senate on June 17th allowed for an additional \$1.3 billion in spending over the \$27.7 billion level.

From the perspective of some Governors and highway interest groups these bills represented a good start, but didn't make the program whole. They continue to seek a larger increase in spending, perhaps to the \$8.6 billion level that would provide the same level of highway spending as FY2002. Congress has now agreed with this argument. Also at issue for such an increase was the willingness of Congress to potentially raise the overall unified budget deficit. This issue was particularly important for the appropriations committees, who must weigh a number of other transportation funding needs and work them into the annual appropriations process. Also important in this regard was the issue of the intent of RABA's authors. As mentioned earlier, the expectation of RABA was that it would provide additional money to the highway program. It is not clear that the authors ever considered that peak RABA levels should become standard for highway program funding. Rather, it appears that the authors expected that the highway program should benefit in bonus years, but also feel some pain in down years.

⁵ Rothman, Heather and Ferguson, Brett. Governors Ask Congress, President to Spend Down Highway Trust Fund. *Daily Report for Executives*. February 26, 2002. p. A-23.

As a result of a provision included in the second FY2002 emergency supplemental appropriations bill (P.L. 107-206)(August 2, 2002) the downward RABA adjustment proposed for FY2003 was blocked. The net effect of this provision was to set the program at its authorized \$27.7 billion level. Later in the Session, the Senate Committee on Appropriations reported S. 2808 which would have increased spending to the FY2002 level. Ultimately Congress has decided to retain funding at the FY2002 level passing the Consolidated Appropriations Resolution, 2003 (P.L. 108-7) early in the 108th Congress.

Trust Fund Balance and Reauthorization Issues

All of the fixes to the RABA adjustment were predicated on spending at least some portion of the unexpended balance in the Highway Trust Fund. Those supporting an increase in the FY2003 limitation on obligations all pointed to the \$18 billion plus unexpended beginning of year balance estimate for the trust fund as the likely source of additional highway funds.⁶ While this was the logical place to look for highway funds, not all of this balance is actually available. At any given time a significant portion of the fund is reserved to meet future obligations. A device created early in the history of the trust fund, known as the “Byrd Rule” (for Senator Harry Byrd, Virginia) requires that the trust fund meet an ongoing fiduciary test. Any failure to meet this test requires an immediate reduction in highway spending.

TEA-21 must be reauthorized prior to FY2004 for the program to continue. Many observers are suggesting that the RABA debate will alert Congress and the highway industry to the fact that long-standing trust fund revenue sources need to be reviewed. This is especially true in terms of gasohol. Gasohol use is expected to increase, but with lower tax levels on gasohol, this actually means that trust fund revenues for the same amount of fuel use could decrease. Also at issue is the ongoing push for the automobile industry to find alternative fuel sources that are not taxed.

When TEA-21 was signed in late 1998 the highway trust fund had a growing unexpended balance that was expected to exceed \$24 billion by the end of FY1999. One of the principal rationales behind the higher spending levels in TEA-21 and the creation of the RABA spending mechanism was to prevent continued growth in this balance. Going into 2003 it now appears that the unexpended balance in the trust fund will be trending downward in size. Should this trend continue it could create a dynamic in which it could be difficult to find support for significant growth in the program during the reauthorization debate without new funding sources.

⁶ The unexpended balance is sometimes and inappropriately referred to as “the surplus”.