



# Intergovernmental Challenges in Surface Transportation Funding

First Report in the *Fiscal Federalism in Action* Series

## Overview

The United States is facing major challenges in maintaining investments in the country's highways and transit systems, which will require policymakers to make difficult choices in the years ahead.<sup>1</sup> These decisions will be made not just at the federal level, but also at the state and local levels.

This analysis examines the role that each level of government plays in paying for highway and transit infrastructure (referred to here as "surface transportation" or "transportation"), the key problems facing this multilayered system of funding, and their causes.<sup>2</sup> In addition, it identifies central principles that policymakers need to consider as they weigh options and consider solutions.

The federal government, states, and localities all make financial contributions to the country's highway and transit system. Between 2007 and 2011, average annual spending on highway and transit nationwide was \$207 billion. Of that total, \$82 billion, or 40 percent, came from states; \$74 billion, or 36 percent, from localities; and \$51 billion, or 25 percent, from the federal government. The relative contributions of each level of government, however, vary from state to state. For example, the percentage of a state's total funding for surface transportation from the federal government ranged from 55 percent in Montana to just 15 percent in New York.<sup>3</sup>

These funding streams are not only sizable; they are also deeply intertwined. In general, the federal government does not directly invest in transportation infrastructure, but sends almost all of its funding to states and localities in the form of grants. States use federal and state dollars to pay for surface transportation and to provide funding to localities—which invest directly, using federal, state, and local funds.

This transportation funding system is confronting significant difficulties in maintaining investments at all levels of government. Between 2002 and 2011, overall spending on surface transportation fell by \$27 billion, or 12 percent in real terms. States have experienced a particularly large decline, with spending falling by \$20 billion, or 20 percent in real terms, over this period.<sup>4</sup>

At the federal level, the highway trust fund, the source of most federal funding for the country's roads and transit infrastructure, has seen revenue fall short of expenditures for more than a decade. Drawing down trust fund balances and transferring money from the general fund have served as temporary fixes, but they do not address the underlying issue of declining revenue. The Congressional Budget Office projects that, absent reforms, trust fund shortfalls will grow to \$162 billion over the next 10 years.<sup>5</sup>

Trust fund shortfalls have implications not just for the federal government but also for states and localities. Roughly 98 percent of federal funding for surface transportation flows to state and local governments, primarily as reimbursements for expenses already incurred. As trust fund balances fall, states and localities could see those payments delayed or reduced.

There is a broad consensus that these transportation funding challenges are occurring at a time when the system needs more investment. For example, the Congressional Budget Office, based on Federal Highway Administration data, finds that just maintaining the current performance of the highway and transit system would require at least \$13 billion more per year than is already spent at all levels of government.<sup>6</sup>

The challenges are due, in large part, to the fact that the gas tax, a major revenue source for surface transportation, hasn't generated enough money in recent years to keep pace with the rising cost of construction. Between 2002 and 2012, federal gas tax revenue fell by \$15 billion, or 31 percent in real terms, while state revenue dropped by \$10 billion, or 19 percent.<sup>7</sup>

Several factors contributed to these revenue declines. Changing driving habits and improved vehicle efficiency have reduced demand for fuel, while gas taxes have not risen to keep up with inflation. The federal gas tax has been 18.4 cents per gallon since 1993,<sup>8</sup> and as of spring 2014, 24 states had not boosted their gas taxes in a decade or more, including 16 that had gone at least 20 years without an increase.<sup>9</sup> At the state level an \$8 billion, or 21 percent, drop in vehicle tax revenue in real terms between 2002 and 2012 has also played an important role in transportation funding difficulties.

These troubles come at a time when the federal government and the states are facing fiscal strain. Federal budget deficits are projected to rise significantly between 2015 and 2024,<sup>10</sup> and although state revenue overall now exceeds prerecession levels, it remains below prerecession peaks in 26 states.<sup>11</sup> These pressures mean that governments have little leeway in their budgets and face difficult trade-offs if they want to maintain transportation investments.

As policymakers consider both short- and long-term solutions for funding surface transportation infrastructure, four key principles can help them evaluate various approaches and address the needs of all levels of government:

1. **Falling revenue forces hard choices.** Transportation investment challenges will not be easily solved. Declines in inflation-adjusted gas and vehicle tax revenue will require the federal government and the states to either raise additional revenue to maintain current spending levels or manage within existing resources by cutting spending in real terms.
2. **Financing is not funding.** Financing measures, such as municipal bond issuances, infrastructure banks, and public-private partnerships, play a prominent role in transportation policy discussions. But while financing is a vital tool for building transportation infrastructure, it is not, by itself, a funding solution. Ultimately, borrowed funds need to be repaid by using taxes, tolls, fees, or other revenue sources.
3. **Rethink the roles of all levels of government.** The purpose and role of federal transportation funding have not been clearly defined since the completion of the interstate highway system in the early 1990s. Any reassessment of the federal role should take into account the fiscal conditions of all levels of government and also consider how states and localities might change the way they fund surface transportation infrastructure to best complement a revised federal approach.
4. **Partnership is essential to confronting challenges.** The various levels of government should communicate and operate as partners. States and localities need to know what to expect from the federal government; in turn, the federal government needs to understand the challenges other jurisdictions face and how policies and procedures might affect them.

This report further examines the findings of this analysis, and it delves into the contributions that all levels of government make in paying for highway and transit infrastructure; the obstacles they confront; and the outlook for addressing these trends so that federal, state, and local investments can meet the nation's transportation needs in the 21st century.

*Pew takes no position on how the nation's transportation system should be funded but believes that it is critical for policymakers to understand the complex roles played by each level of government in paying for this infrastructure.*

## Endnotes

- 1 Highways, as used in this paper, is a broad term that encompasses roads, bridges, tunnels, and most other forms of infrastructure that accommodate motor vehicle traffic. Transit refers to buses, subways, commuter trains, and other forms of public mass transit.
- 2 For other efforts to map transportation funding across levels of government, see National Surface Transportation Infrastructure Financing Commission, "Paying Our Way: A New Framework for Transportation Finance" (February 2009), [http://financecommission.dot.gov/Documents/NSTIF\\_Commission\\_Final\\_Report\\_Advance%20Copy\\_Feb09.pdf](http://financecommission.dot.gov/Documents/NSTIF_Commission_Final_Report_Advance%20Copy_Feb09.pdf); and Congressional Budget Office, "Public Spending on Transportation and Water Infrastructure" (Nov. 17, 2010), <http://www.cbo.gov/publication/21902>.
- 3 Pew's analysis of U.S. Census Bureau, "2011 Annual Survey of State and Local Government Finances" (July 24, 2013), <http://www.census.gov/govs/local>.
- 4 Pew's analysis of U.S. Census Bureau, "2002-11 Annual Survey of State and Local Government Finances" (July 24, 2013), <http://www.census.gov/govs/local>.
- 5 Congressional Budget Office, "Projections of Highway Trust Fund Accounts Under CBO's August 2014 Baseline" (August 27, 2014), [http://www.cbo.gov/sites/default/files/cbofiles/attachments/43884-2014-08-Highway\\_Trust\\_Fund.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/43884-2014-08-Highway_Trust_Fund.pdf). The \$162 billion includes a \$115 billion shortfall in the highway account, a \$42 billion shortfall in the mass transit account, and a \$5 billion cash balance that the U.S. Department of Transportation says is necessary in order to meet obligations as they come due.
- 6 Kim P. Cawley, "Testimony: Status of the Highway Trust Fund," Congressional Budget Office (July 23, 2013), [http://www.cbo.gov/sites/default/files/cbofiles/attachments/44434-HighwayTrustFund\\_Testimony.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/44434-HighwayTrustFund_Testimony.pdf).
- 7 Pew's analysis of Federal Highway Administration, "Table FE-210: Status of the Highway Trust Fund 1957-2012" (February 2014), <http://www.fhwa.dot.gov/policyinformation/statistics/2012/fe210.cfm>; Federal Highway Administration, "Table SDF: Disposition of State Highway-user Revenues - 2012" (December 2013), <https://www.fhwa.dot.gov/policyinformation/statistics/2012/sdf.cfm>; and Federal Highway Administration, "Table SDF: Disposition of State Highway-user Revenues - 2002" (December 2003), <http://www.fhwa.dot.gov/policy/ohim/hs02/sdf.htm>. Federal gas and vehicle tax revenue is reported in federal fiscal years; states' revenue is reported in state fiscal years.
- 8 Sarah Puro, "Status of the Highway Trust Fund," Congressional Budget Office (April 24, 2013), <http://www.cbo.gov/sites/default/files/cbofiles/attachments/44093-HighwayTrustFund.pdf>.
- 9 Institute on Taxation and Economic Policy, "How Long Has It Been Since Your State Raised Its Gas Tax?" (April 1, 2014), [http://itep.org/itep\\_reports/2014/04/how-long-has-it-been-since-your-state-raised-its-gas-tax.php#.U5C5sfmzHAs](http://itep.org/itep_reports/2014/04/how-long-has-it-been-since-your-state-raised-its-gas-tax.php#.U5C5sfmzHAs).
- 10 Congressional Budget Office, "An Update to the Budget and Economic Outlook: 2014 to 2024" (August 2014), <http://www.cbo.gov/publication/45653>.
- 11 The Pew Charitable Trusts, "State Tax Revenue Grows, But a Full Recovery Still Eludes 26 States," May 19, 2014 (updated June 3, 2014), <http://www.pewstates.org/research/analysis/state-tax-revenue-grows-but-a-full-recovery-eludes-26-states-85899545362>.



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