Federal Gridlock Delays National Transportation Infrastructure Investment

By Dustin McDonald

Congress and the White House are eyeing a large-scale reform of the federal tax code as a solution to backfill the fledgling Highway Trust Fund. But how far will that get us down the road?

With the federal government expected to run out of money for transportation infrastructure projects in July or August and no politically palatable revenue sources available to support an extended six-year surface transportation reauthorization bill, federal lawmakers find themselves facing the familiar conundrum of how to finance our nation's roads, bridges and transit systems, as well as debating the role of the federal government in building and maintaining these networks. As discussions continue Congress and the White House are eyeing a large-scale reform of the federal tax code as a solution to backfill the fledgling Highway Trust Fund. But how far will that get us down the road?

ROAD CLOSED: FIXING THE HIGHWAY TRUST FUND

The Highway Trust Fund was established in 1956 to finance the U.S. interstate highway system. The fund receives money from a federal fuel tax of 18.3 cents per gallon on gasoline and 24.4 cents per gallon of diesel fuel and related excise taxes, and steers this funding to federal transportation programs through the Highway Account, which funds road construction, and the Mass Transit Account, which supports bus and light rail systems. For the last few decades, Congress has modified how money from the fund is spent on federal transportation programs through multi-year bills (typically every six years), designed to give states, to whom much of the funding is directed, assurance in planning and financing statewide and regional transportation improvements.

Over the last seven years, however, increased fuel efficiency in vehicles as well as a recession-induced drop-off in driving has lowered gas-tax revenues to the highway fund, leading to tough debates in Congress and among transportation advocates over how best to keep the needed revenues flowing. While some say the fuels tax should be raised, others say usage-based alternatives such as a vehicle miles tax and greater tolling authority are needed. With no interference, the Congressional Budget Office forecasts that the Highway Trust Fund will have a $13 billion gap between revenue and obligations in fiscal 2016. And U.S. Transportation Secretary Anthony Foxx has stated that the department will have to start taking cash management measures to keep the fund afloat by late July or early August if Congress fails to act.

This is not the first time that Congress has faced this dilemma. Congress periodically approves short-term extensions of surface transportation laws and money from the General Fund to the Highway Trust Fund to maintain the

federal commitment to the interstate highway system and state and local projects. Since 2008, lawmakers have transferred $53.6 billion in this manner, and there have been 32 short-term extensions of the highway funding law during the last six years. This includes the first half of 2015, which is being funded through a series of short-term extensions of MAP-21, the two-year, flat-funded transportation reauthorization bill enacted in July of 2012. Emergency cash infusions, which are estimated to increase transportation project costs by close to 30 percent, will continue unless Congress agrees on a long-term funding formula for the Trust Fund.

But members of Congress are divided over how to pay for a new six-year surface transportation authorization bill. Raising the federal gas tax, which has not been increased since 1994 or adjusted for inflation since that time, would seem to be an attractive solution. However, many Republicans are uncomfortable with increasing the gas tax, given the political undesirability of increasing any kind of tax in Washington. Additional concerns about the reliability of the gas tax as a consistent funding source have been raised by House Transportation and Infrastructure Committee Chairman Bill Shuster (R-PA) and President Obama, who have expressed a preference for identifying some other more consistent funding mechanism to fund federal transportation programs through 2021. Also off the table are effective alternatives such as project earmarks, which existed under every transportation reauthorization bill before MAP-21, and drove federal dollars to big projects in congressional districts to ease any heartburn over transferring money from the General Fund to the Highway Trust Fund. With these tools removed from the discussion, polarization among federal lawmakers is only increasing.

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The current debate demonstrates just how much the discussion on national infrastructure investment has changed in Washington. Ten years ago, Republicans and Democrats alike were reliable backers of infrastructure spending, a priority that routinely united business and labor groups. Today there is an ongoing divide between infrastructure-minded Republicans, who favor a federal role in national infrastructure development, and a sizable and vocal group of their more conservative colleagues, who want to either freeze or reduce the federal gas tax and shift the responsibility of infrastructure spending onto the states.

Meanwhile the state of the nation's infrastructure declines with the outlook on the country's future economic competitiveness uncertain. The American Society of Civil Engineers gave American roads a D grade in a 2013 report. The group, which stands to benefit from more infrastructure spending, said 42 percent of urban highways are congested, costing the economy $101 billion a year in wasted time and fuel. The Federal Highway Administration also estimated in a 2013 study that federal, state and local governments would need to invest $65 billion to $86 billion a year to keep roads in their current state, depending on whether people drive more or less in the future. To improve conditions, the study said, highway capital spending would have to be between $124 billion and $146 billion a year. Those improvements would cost far more than the $91.9 billion in capital spending from all levels of government, according to the Congressional Budget Office. It is not clear that Congress can find agreement on just where those levels of funding will come from, leaving state and local officials to ponder the future of transportation for their communities.

Ordinarily, states sign contracts for construction projects, and then ask the federal government to reimburse them. In the era of six-year fully funded surface transportation bills, states knew that they could expect a steady stream of money, giving them the confidence to embark on expensive long-term projects. Now that Congress relies on short-term funding bills that often last only for a few months, state officials are much more nervous about signing multi-year contracts.

MERGE AHEAD: COMBINING TRANSPORTATION REAUTHORIZATION AND TAX REFORM

Tax reform was one of the few areas identified at the start of the year where Congress and the White House might find compromise. House and Senate leaders and the President have also

acknowledged that funding from reform of the corporate side of the tax code could be used to backfill the Highway Trust Fund. Awareness of this possibility is fueling continued discussions between Congress and the White House that could merge transportation reauthorization and tax reform later this year.

Leading the tax reform track in the House is House Ways & Means Committee Chairman Paul Ryan (R-WI). Though Chairman Ryan would prefer to craft a comprehensive tax reform package, he recognizes the obstacles to advancing such a package. Mr. Ryan's predecessor Dave Camp (R-MI) shared the same goal, and dedicated six years to constructing a full-scale tax reform bill that was ultimately abandoned by party leadership, who were all too aware the measure wouldn't make it past the House floor. Cognizant of these obstacles, Chairman Ryan is supportive of a multi-year comprehensive tax reform strategy that would at first focus on corporate tax reform, and reach reform of the individual side of the tax code in 2017 (post-presidential election). The White House also prefers a corporate-first reform plan, largely because it sees this exercise as a way to tax the foreign profits of U.S. companies and funnel those new revenues, which it estimates will generate $238 billion, into the federal Highway Trust Fund. And while House tax reform discussions move forward, House Transportation and Infrastructure Committee leaders continue to consult with Chairman Ryan on the financing component of the six-year transportation reauthorization bill they are organizing.

Leading the tax reform track in the Senate is Senate Finance Committee Chairman Orrin Hatch (R-UT), who has indicated his preference for moving a comprehensive tax reform package as opposed to a corporate-only tax reform bill. Towards this end Senator Hatch kicked off the committee's work on organizing the Senate's tax reform plan in March with the announcement of five bipartisan working groups to explore the existing federal tax code and identify areas that are ripe for reform. The five working groups are — (1) Individual Income Tax; (2) Business Income Tax; (3) Savings & Investment; (4) International Tax; and (5) Community Development & Infrastructure. Each of the groups will work with the Joint Committee on Taxation (JCT) to develop reform recommendations, and aim to assemble a report covering all five working group areas by the end of May. The final report will serve as a blueprint for Senate Finance Committee leaders to use in shaping tax reform legislation, as well as offering suggestions to prop-up the Highway Trust Fund for the next six years. In the meantime, leaders of the Senate Environment & Public Works Committee and Senate Commerce Committee, which hold jurisdiction over the shape of federal transportation programs, are also developing legislative proposals on a new transportation bill, though few details of those drafts have been released.

THREE WAY CROSSING: WHITE HOUSE PROPOSES OPTIONS

The White House unveiled its priorities on corporate tax reform and a new transportation reauthorization in February when it released its FY 2016 budget proposal. Highlights of the plan are outlined below, though it is important to note that these proposals are only suggested policy preferences, and are very unlikely to find support among the House and the Senate majority.

The 28 Percent Cap — Reiteration of the 28 percent cap proposal on investor income tax deductions would include tax-exempt income. GFOA and our state and local coalition partners have vigorously opposed this proposal each time the White House has offered it over the last three years because it would eliminate the tax-exempt nature of tax-exempt bonds, and in the process cost state and local government debt issuers more in interest costs. It is estimated that if the proposal to cap the exemption on municipal bonds at 28 percent had been in place over the last 10 years it would have cost state and local governments an additional $173 billion in interest costs. GFOA is again leading efforts to oppose this provision in 2015, and is circulating a draft joint letter to our state and local government association partners.

Surface Transportation Reauthorization Proposal — A $478 billion transportation infrastructure plan seeks to secure $278 billion from a new tax rate on corporate foreign earnings. The new 14 percent tax would be levied on corporate foreign profits even if they remain overseas.

America Fast Forward Bonds — This is a taxable, direct-pay Build America Bonds (BABs)-type program with a 28 percent subsidy instead of the original 35 percent subsidy that was provided for BABs. AFF bonds could be used for current refundings,

short-term working capital, financing of eligible non-profits and for qualified private activity bonds (PABs). GFOA has some concerns with this proposal, chief among them the attrition in federal subsidy payments for the BABs program. Following the huge success of the program ($182 billion in BABs issued over the two-year life of these products), the White House agreed to reduce subsidy payments to BAB issuers at varying levels through 2024 (8.7 percent in 2013, 7.2 percent in 2014, and 7.3 percent in 2015) as part of the Budget Control Act of 2011. State and local governments will be reluctant to partner with the federal government again on a similar program based on their experience with BABs.

National Infrastructure Bank — The bank would issue grants and loans to state and local governments to help finance infrastructure projects of national and regional significance. GFOA has a number of concerns with this concept as well, including the feasibility of finding a reliable capitalization source for the bank, the lengthy and political process that might be involved with federal selection of state and local projects to be funded by the bank, impact of a federal infrastructure bank on already existing state infrastructure banks, and what impact such a bank might have on the tax-exempt bond market.

Qualified Public Infrastructure Bonds (QPIBs) — The program would augment Private Activity Bonds (PABs), to expand the scope of PABs to include financing for airports, ports, mass transit, solid waste disposal, sewer and water, as well as for more surface transportation projects. QPIBs would have no expiration date or issuance caps and the interest on the bonds would not be subject to the alternative minimum tax (AMT). Projects financed by QPIBs would have to be owned by a state or local government unit and would have to serve a public use or be available on a regular basis for general public use. They also would not have the private business use test that is currently are used to determine if bonds are governmental bonds or PABs.

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GFOA has concerns with this proposal, the primary one being the tremendous congressional scrutiny of PABs in 2013 that stemmed from their misuse for projects that either exceeded the 10 percent private use test or were used to finance a project that was not qualified. Under current law, bonds are PABs and not government bonds if more than 10 percent of the project is used by private parties and more than 10 percent of the debt service is paid for, or secured by, private parties. To be tax exempt, however, a PAB has to be used to finance a project that falls within one of several categories, including airports and sewer facilities (known as qualified projects).

The focus of the only hearing that Congress held on the infrastructure investment segment of the tax code in 2013 was squarely on whether or not to continue supporting PABs based on these abuses. As proposed, the QPIB program appears to be a new type of PAB that would remove any requirements to meet a private use test and allow state and local governments to issue an unlimited number. This recipe seems ripe for disaster. It is not difficult to imagine abuse of these bonds that would culminate in additional federal scrutiny of the debt issuance practices of state and local governments, and further threaten repeal of the Tower Amendment.

Increase of Bank Qualified Debt Limit — The issuer annual cap would be increased from $10 million to $30 million. GFOA has actively advocated for this increase for a number of years now, and is currently working with a bipartisan group of House and Senate members to introduce legislation that would increase the bank qualified debt limit. Bank qualified bonds are particularly useful to smaller governments, historically saving issuers 25 to 40 basis points on a bond deal. A 25 basis point savings on an average bank-qualified debt financing of $3.89 million over 15 years at current interest rates would be $146,000. Similarly, a 40 basis point savings on a 15-year $3.89 million bond would be $233,000.

THE ROAD AHEAD

Federal elected leaders acknowledge that they have a short window to complete action on a corporate tax reform and transportation reauthorization package in 2015. They will not be able to make enough progress on this effort by the end of May 2015, when the

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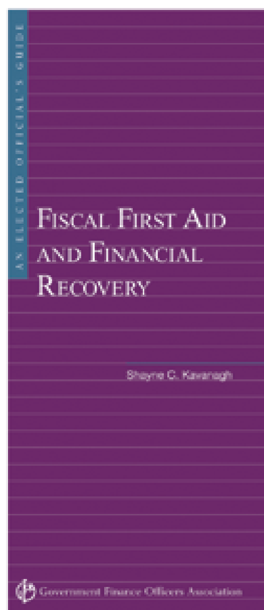

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current transportation patch expires, so a short-term extension of existing federal transportation law is likely. Looking further ahead, the Iowa Straw Poll is on August 8. This event will likely mark a turning point in the priorities of tax reform decision makers, as well as change the dynamics of negotiations to reach a tax reform or transportation reauthorization deal. Following the Straw Poll the attention of lawmakers will turn away from legislating and toward presidential campaigning, which leaves only a few months for congressional leaders and the White House to make progress.

As federal discussions continue, GFOA is engaging members of the House Ways and Means Committee, Senate Finance Committee (and its working group leaders) and House and Senate transportation authorizing committees on our priorities in these discussions, the first of which is preservation of the tax exemption on municipal bond interest. So far this year we have helped congressional staff organize a bipartisan letter to House leadership outlining the need to preserve the tax exemption, and helped attract over 100 cosponsors to the letter. We have initiated talks with our Senate tax exemption champions as well about organizing a similar movement in the Senate. GFOA members interested in participating in our advocacy efforts are encouraged to visit the Federal Government Relations section on our website and use the advocacy materials we have prepared to join the effort.

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