

# FEDERAL AID HIGHWAY FUNDING FEDERAL FISCAL YEAR 2003 REDUCTION

A Report Prepared for the

## **Legislative Finance Committee**

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March 4, 2002  
(revised)

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## **INTRODUCTION**

Recently, newspaper headlines have been warning of an imminent federal aid funding reduction for highways. Although the federal budget isn't finalized for fiscal 2003, Montana will likely see fewer federal-aid highway dollars during federal fiscal year 2003. This letter updates the committee on the reason, amount, and impacts of this potential reduction. In summary, the bottom line is:

- Existing projects (those currently awarded for construction) should not be impacted
- Future projects (those where construction lettings anticipate using federal fiscal year 2003 federal-aid obligations) could be delayed depending upon their priority in the overall project list
- The Department of Transportation does not anticipate a budget shortfall for the currently planned construction program during the 2003 biennium

## **FEDERAL AID IS ALIGNED WITH REVENUES**

The Transportation Efficiency Act for the 21<sup>st</sup> Century (TEA-21)<sup>1</sup> contains a “*new provision that provided special budgetary treatment for a portion of the highway program and the first real link between the receipts of the Highway Account [federal] and the funding for the programs it supports. The link, known as Revenue Aligned Budget Authority, allows the adjustment of highway program funding levels when the Highway Account revenue levels differ from the baseline levels assumed in the development of TEA-21.*”<sup>2</sup> The federal aid funding reduction identified in the newspapers is the result of the Revenue Aligned Budget Authority (RABA) adjustment provision and the Department of the Treasury's assumptions used to develop it. All states, not just Montana, will receive proportionate reductions in federal-aid obligation authority due to this provision.

RABA adjustments are made each year to reflect actual Highway Trust Fund receipts from previous years and updated revenue estimates in future years. The original TEA-21 baseline obligation levels are then modified accordingly. This look back and look ahead approach is intended to make all trust fund revenues available to the highway program. Separate mechanisms exist which ensure the trust fund balance will be maintained at a level adequate to meet future commitments. When TEA-21 was authorized in 1998, estimates of trust fund surpluses, income, and future payouts were used to develop base program funding levels for each of the six years of its life. As time has progressed through the life of this authorizing legislation, these “baseline” estimates were found to be very conservative. Consequently in federal fiscal years 2000, 2001, and 2002 the RABA provision distributed additional obligation authority to the states. Because some

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<sup>1</sup> TEA-21 is the federal authorizing legislation that establishes the guidelines and funding provisions for federal participation in highway related costs.

<sup>2</sup> Source: Primer: Highway Trust Fund, Federal Highway Administration Office of Policy Development, November 1998.

of the previous revenue estimates for the Highway Trust Fund were high and updated revenue estimates are lower for future years, the mechanics of the RABA calculation will take obligation levels below the TEA-21 baseline level of \$27.7 billion in federal fiscal year 2003. Updated revenue estimates are lower for federal fiscal year 2003 because of slower growth in fuel tax receipts, depressed truck sales, and increased gasohol sales (which are taxed at lower rates than gasoline).

## AMOUNT OF ADJUSTMENT

Based on the President’s fiscal 2003 Budget, Federal Highway Administration tables indicate that Montana would receive a negative RABA of roughly \$41.2 million in federal fiscal year 2003 (October 1, 2002, to September 30, 2003). Nationally, the fiscal 2003 negative RABA would be nearly \$5 billion. In contrast, a positive \$4.5 billion RABA was distributed to states in federal fiscal year 2002 and a positive \$9.1 billion from federal fiscal years 2000 through 2002. Table 1 shows Montana’ share of the RABA adjustments.

Although the adjustment has a negative impact for federal fiscal year 2003, Montana has also benefited from previous positive RABA adjustments. Table 1 shows RABA adjustments received by Montana during the life of TEA-21. As the table shows, Montana has benefited overall from the RABA provision and the corresponding increased revenues into the federal Highway Trust Fund. Table 1 shows that Montana has received nearly \$35 million more federal funding through the RABA provision than was anticipated when TEA-21 was authorized.

Federal Fiscal Year	Amount	Cumulative Amount
2000	\$13,225,643	\$13,225,643
2001	27,412,975	40,638,618
2002	35,516,589	76,155,207
2003	-41,235,033	34,920,174

Source: Montana Department of Transportation, Transportation Planning Division

To put this into perspective, Montana received roughly \$271 million federal highway funding in federal fiscal year 2002. This included the \$35.5 million RABA positive adjustment above the \$235.5 million base level funding of TEA-21. With the negative RABA adjustment in federal fiscal year 2003, Montana would receive roughly \$204.8 million or \$66.2 million less than in federal fiscal year 2002.

Nationally the discussion focuses on the funding level difference between federal fiscal years 2002 and 2003 using the total funding including the RABA adjustments. Justification for this reference is that the total amounts are used to plan the highway programs, both nationally and in Montana. However, the current situation highlights a potential problem with this approach. The problem is that states have grown to expect that all funding is entitled. Historical, RABA adjustments have been positive and have experienced a positive growth until now. Nationally, states have planned highway programs around the assumption that RABA adjustments would continue to be positive and would be larger each succeeding year. TEA-21 clearly identifies baseline-funding

levels and potential RABA adjustments that are tied to Highway Trust Fund revenue factors. Nothing in TEA-21 states that adjustments would only be positive.

## **WHAT IS THE IMPACT?**

### **OBLIGATIONS**

The Montana Department of Transportation (MDT) has been obligating all of the federal funds authorized for Montana. Obligating means that the department has established agreements with the Federal Highway Administration (FHWA) to reimburse the state for a share of costs on applicable highway projects in Montana. The federal funds are obligated as project bids are announced. When obligated, a commitment is established against the federal Highway Trust Fund. Projects associated with previously obligated funds should not be impacted by this negative adjustment. The major impact is for projects planned to be financed with the federal fiscal year 2003 funds. For these projects, delays could occur if their priorities are such that they fall below available funding levels. Work on existing projects should not be impacted by this adjustment.

### **BUDGET**

There is a natural delay between when funds are obligated and when the actual expenditures on the associated projects occur. On any given project, this delay can be impacted by such factors as:

- The phase of the project (preliminary engineering, right-of-way, construction engineering, or construction)
- The type of project (reconstruction, pavement overlay, sign replacement, etc.)
- The weather (primarily for projects in the construction phase)
- Contractor startup and staging
- Contractor progress toward completing billable project activities

MDT's 2003 biennium budget for federal funds and for state funds to match the federal funds was based on a construction plan that projected the level of funding available and a project profile that would be funded with the funds. RABA adjustments for the biennium were not known at the time the budget was developed. However, RABA adjustments when adjusted to the state fiscal years of the 2003 biennium are offsetting, except for a net \$11.4 million biennium increase of federal obligations<sup>3</sup>. This net increase is also impacted by the delays, mentioned above, between obligating and expending the federal aid funds, so expenditures of the net increase should not all occur during the 2003 biennium.

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<sup>3</sup>  $\$27.4 \text{ million} / 4$  [1 quarter of federal fiscal year 2001 RABA] +  $\$35.5 \text{ million}$  [federal fiscal year 2002 RABA] -  $3 * (\$41.2 \text{ million} / 4)$  [3 quarters of federal fiscal year 2003 RABA] =  $\$11.4 \text{ million}$

The department included an estimate for RABA increases in the construction plan used to develop the 2003 biennium budget. As such, the department doesn't expect a budget shortfall for the construction program currently planned for the 2003 biennium.

## **FISCAL POLICY IMPLICATIONS**

Over the life of TEA-21, Montana has received more in positive RABA adjustments than the projected negative adjustment. However, the legislature could partially offset these negative impacts of the funding reduction by using state funds to finance a portion of the reduced federal funding. MDT projects that the highways state special revenue account will end fiscal 2002 with a \$45 million balance. This balance assumes the \$6.1 million state match would be spent. If the state match was not spent on construction projects, the effective impact of the \$41 million negative RABA adjustment would be roughly \$47 million reduction and the state special revenue balance could be \$51 million at the end of fiscal 2002.

Based on testimony at the February 2002 hearing before the Revenue and Transportation Interim Committee, MDT officials indicated that they might propose initiatives for funding more construction activities through the state funded construction program.

As such, the committee may wish to consider including MDT on a future committee agenda to discuss:

- Issues surrounding the use of the state funded construction program (construction activities funded 100 percent with state funds)
- Department plans for addressing any future negative RABA adjustment in their planning process

If the committee concurs in this recommendation, it may wish to provide a list of issues staff could use to develop the agenda item.

## **POTENTIAL RESTORATION**

Two similar Congressional initiatives are currently underway to restore the federal-aid highway program obligation levels to the TEA-21 baseline level for federal fiscal year 2003. Both initiatives, one originating in the House of Representatives and the other in the Senate, are titled "Highway Funding Restoration Act." For Montana, these initiatives would add roughly \$36.3 million to the administration's funding levels, thus overcoming the negative RABA adjustment. If the "Highway Funding Restoration Act" were successful, Montana would receive \$241.1 million federal highway funding in federal fiscal year 2003 or roughly \$30 million less than in federal fiscal year 2002.