# HIGHWAYS SPECIAL REVENUE ACCOUNT SOLVENCY: ADDITIONAL INFORMATION

Prepared for the

**Legislative Finance Committee**

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# INTRODUCTION

At the Legislative Finance Committee (LFC) meeting in October 2000, a report titled, Highway State Special Revenue Account: Working Capital Update, was presented. This report identified that the account has a structural imbalance between revenues and expenditures that would drive the account into a negative financial position during fiscal 2002. During the LFC meeting, the committee requested that Legislative Fiscal Division staff provide additional information for various options for improving the financial condition of the account. This report provides estimates associated with seven options.

## OPTIONS

Estimates of the impacts on the highways special revenue account are provided for the following seven options:

?? Option 1: Expenditure reductions to maintain ending working capital balances of $10 million.
?? Option 2: Bonding to provide an ending working capital balance of $10 million in fiscal 2005.
?? Option 3: Gasoline tax increase.
?? Option 4: Remove the Department of Justice from highways special revenue account funding.
?? Option 5: Remove the Department of Justice non-highway patrol functions from highways special revenue account funding.
?? Option 6: Dyed diesel enforcement.
?? Option 7: Department of Transportation budget reductions.

For more details on each option please refer to the supporting schedules for each option that are attached to this report.

The expenditure reduction option (Option 1), bonding option (Option 2), and gasoline tax increase option (Option 3) were developed to maintain the ending working capital balance at or above $10 million each fiscal year starting in fiscal 2002. The gasoline tax increase option (Option 3) also attempts to identify a tax increase to the nearest quarter of one cent per gallon that would maintain the desired ending working capital balance. All other options are presented to show their impacts to the account.

## STARTING POINT FOR IMPACT ESTIMATES

Since the October LFC meeting the executive has been developing the budget for the Department of Transportation. Because the budget is in a state of flux during its development, the expenditure estimates used in this report to illustrate the impacts of the options are based on the original agency budget submission. Table 1 provides an update to the working capital analysis that was presented at the October 2000 LFC meeting. The final budget request will most likely not match the amounts used in this report. Once the executive has submitted the final budget for the department, a more up-to-date analysis will be provided in the Legislative Budget Analysis 2003 Biennium.

Table 1
Highway Special Revenue Account Solvency: Additional Information
Projected Revenues and Expenditures
Fiscal Years 2000 -2005

| | Fiscal 2000 Actual | Fiscal 2001 Appropriated | Fiscal 2002 Estimate | Fiscal 2003 Estimate | Fiscal 2004 Estimate | Fiscal 2005 Estimate |
|---|---|---|---|---|---|---|
| Beginning Working Capital Balance | $48,974,472 | $23,542,223 | $6,358,530 | ($3,442,744) | ($2,642,605) | ($553,193) |
| Revenue: | | | | | | |
| Gas Tax | $124,679,120 | $126,129,000 | 127,592,000 | $129,076,000 | $130,577,154 | $132,095,766 |
| Diesel Tax | 54,259,213 | 55,886,990 | 57,563,599 | 59,290,507 | 61,069,222 | 62,901,299 |
| G.V.W. | 33,934,696 | 32,366,000 | 29,515,000 | 29,668,000 | 29,821,680 | 29,976,157 |
| Other revenue | 5,174,406 | 5,174,406 | 5,174,406 | 5,174,406 | 5,174,406 | 5,174,406 |
| Interest | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Revenue | $218,047,435 | $219,556,396 | $219,845,005 | $223,208,913 | $226,642,462 | $230,147,628 |
| Expenditures: | | | | | | |
| MDT Expenditures | | | | | | |
| General Operations | $14,010,603 | $14,530,794 | $16,914,622 | $16,587,063 | $17,084,675 | $17,597,215 |
| Tribal Refunds - SA | 24,435 | 28,036 | 28,877 | 29,743 | 30,636 | 31,555 |
| Construction | 90,891,133 | 46,593,998 | 70,879,274 | 73,624,731 | $75,833,473 | $78,108,477 |
| Construction potential funding switch (federal to state special revenue) | | 27,393,102 | | | | |
| Maintenance | 69,930,872 | 79,608,356 | 81,708,236 | 82,107,318 | 84,570,538 | 87,107,654 |
| Motor Carrier Services (G.V.W.) | 4,823,500 | 5,002,278 | 5,019,923 | 5,043,982 | 5,195,301 | 5,351,161 |
| Transportation Planning | 1,560,620 | 1,576,013 | 1,945,433 | 1,740,083 | 1,792,285 | 1,846,054 |
| Debt Service/Bond Principal & Interest | 13,536,080 | 13,935,352 | 13,936,852 | 3,798,551 | 0 | 0 |
| Total MDT Expenditures | $194,777,243 | $188,667,929 | $190,433,217 | $182,931,471 | $184,506,908 | $190,042,115 |
| Local Distributions | | | | | | |
| County Distribution - SA | 10,389,000 | 10,389,000 | 10,389,000 | 10,389,000 | 10,389,000 | 10,389,000 |
| City Distribution - SA | 6,323,000 | 6,323,000 | 6,323,000 | 6,323,000 | 6,323,000 | 6,323,000 |
| SA | 54,000 | 54,000 | 54,000 | 54,000 | 54,000 | 54,000 |
| Total Local Distributions | $16,766,000 | $16,766,000 | $16,766,000 | $16,766,000 | $16,766,000 | $16,766,000 |
| Other Agency Expenditures | | | | | | |
| Department of Justice | 16,494,329 | 17,252,851 | $18,697,062 | $18,961,303 | $19,530,142 | $20,116,046 |
| HB 5 Long-Range Building Program (Dept. of Fish, Wildlife & Parks) | 502,091 | 1,656,504 | 750,000 | 750,000 | 750,000 | 750,000 |
| HB 5 Long-Range Building Program (MDT Facilities) | 1,897,948 | 2,509,907 | 3,000,000 | 3,000,000 | 3,000,000 | 3,000,000 |
| Total Other Agency Expenditures | $18,894,368 | $21,419,262 | $22,447,062 | $22,711,303 | $23,280,142 | $23,866,046 |
| Equipment program contributed capital (SB 333 Startup) | 4,342,201 | 8,761,898 | | | | |
| Transfer to Noxious Weed Management Trust Fund (SB 164) | 1,125,000 | 1,125,000 | | | | |
| Other transfers | 15,000 | | | | | |
| Total Expenditures | $235,919,812 | $236,740,089 | $229,646,279 | $222,408,774 | $224,553,050 | $230,674,162 |
| Net Adjustments | (7,559,872) | | | | | |
| Revenue and Expenditure Variance | ($17,872,377) | ($17,183,693) | ($9,801,274) | $800,139 | $2,089,412 | ($526,534) |
| Ending Working Capital Balance | $23,542,223 | $6,358,530 | ($3,442,744) | ($2,642,605) | ($553,193) | ($1,079,727) |

With one exception, the attached schedules show only the impacts of present law expenditures on the account financial condition. New proposals and pay plan expenditures are also shown for the expenditure reduction option (Option 1). Separate schedules are not attached to show the impacts on the account if new proposals and 3 percent annual pay plan increases are approved. Instead, estimates of the impacts of new proposals and pay plan increases on the fiscal 2005 ending working capital balance are provided for all options.

Unlike expenditures, the revenue figures for fiscal years 2001 through 2003 have been updated to reflect the Legislative Fiscal Division revenue estimates that will be presented to the Revenue and Taxation Committee for consideration as the official legislative revenue estimates for the 2003 biennium. The revenue estimates for fiscal years 2004 and 2005 are the fiscal 2003 estimates inflated by the same annual growth rates used in the estimates for fiscal years 2001 through 2003. Interest income on the account cash balance is calculated at 4 percent and will begin being credited to the account in fiscal 2002.

## *OPTION 1: EXPENDITURE REDUCTIONS TO MAINTAIN ENDING WORKING CAPITAL BALANCES OF $10 MILLION*

Option 1 provides estimates of expenditure reductions that would be needed to maintain the ending working capital balances at $10 million for each year from fiscal 2002 through fiscal 2005. For present law, reductions would only be needed in fiscal years 2002 and 2005 to maintain a $10 million ending working capital balance in each year. Reductions would be needed in all years if new proposals and pay plan increases are approved. Reductions would imply that the agencies identify offsetting reductions in other program areas to compensate for the impacts of the new proposals and pay plan increases.

The allocations were based on fiscal 2000 actual expenditures made by agencies and capital projects funded with the highways special revenue account. Allocations were applied on a prorated basis against the total reduction needed to maintain the ending working capital balance at $10 million in each year. Table 2 shows the estimated reductions and the allocation of the reductions for: 1) present law only; and 2) present law, new proposals, and pay plan.

Highways special revenue expenditures in the Department of Transportation are roughly $190 million per year. Therefore, the reductions shown on Table 2 range from 3.8 percent for fiscal 2002 with legislative approval of present law, new proposals, and pay plan increases to 0.5 percent in fiscal 2005 for legislative approval of present law expenditures. Department of Justice (DOJ) expenditures of highways special revenue are roughly $19 million per year. The reductions for DOJ range from 4.5 percent in fiscal 2002 with legislative approval of present law, new proposals, and pay plan increases to 0.6 percent in fiscal 2005 for legislative approval of present law expenditures. The capital project request for Fish, Wildlife & Parks is $1.5 million for the 2003 biennium. The reduction would equate to 1.6 percent of this request. The capital project request for MDT facilities is $6.0 million for the 2003 biennium. The reduction would equate to 1.6 percent of this request.

Table 2
Expenditure Reductions - Present Law

| Agency | Fiscal 2002 | Fiscal 2003 | Fiscal 2004 | Fiscal 2005 |
|---|---|---|---|---|
| Present Law only | | | | |
| Department of Transportation | $6,097,460 | ($1,073,591) | ($2,226,917) | $113,192 |
| Department of Justice | 598,659 | (105,407) | (218,643) | 11,113 |
| HB 5 Long-Range Building Program (Dept. of Fish, Wildlife & Parks) | 24,014 | (4,228) | (8,770) | 446 |
| HB 5 Long-Range Building Program (MDT Facilities) | 96,057 | (16,913) | (35,082) | 1,783 |
| Total Reduction - Present Law | $6,816,190 | ($1,200,139) | ($2,489,412) | $126,534 |
| Present Law, New Proposals, and Pay Plan | | | | |
| Department of Transportation | $7,268,243 | $1,666,450 | $885,296 | $3,225,405 |
| Department of Justice | 860,569 | 507,554 | 477,576 | 707,332 |
| HB 5 Long-Range Building Program (Dept. of Fish, Wildlife & Parks) | 24,014 | (4,228) | (8,770) | 446 |
| HB 5 Long-Range Building Program (MDT Facilities) | 96,057 | (16,913) | (35,082) | 1,783 |
| Total Reduction - Present Law,New Proposals, and Pay Plan | $8,248,883 | $2,152,863 | $1,319,020 | $3,934,966 |

## *OPTION 2: BONDING TO PROVIDE AN ENDING WORKING CAPITAL BALANCE OF $10 MILLION IN FISCAL 2005*

Option 2 provides estimates of a one-time bond issue that would be needed to maintain the ending working capital balances at $10 million or above for each year from fiscal 2002 through fiscal 2005. For the purposes of the illustration, the following assumptions were used to determine the costs associated with the bond issue:

?? 4.25 percent for annual bond interest costs; and
?? 1 percent for issue, underwriter, and administration costs.

Because bonds can be structured in a number of ways, the illustration is for a one-time gasoline tax revenue bond that would be paid in four equal principal payments. The assumptions for interest and bonding costs are based on discussions with a financial advisor under contract with the state.

Given the assumptions, a bond issue of roughly $51.2 million at the beginning of fiscal 2002 would be needed to keep the account above $10 million through fiscal 2005. The bond would cost the account an additional $540,000 over the four-year period. The factors for this additional cost are: 1) the cost to issue, underwrite, and administer the bond; and 2) the difference between the interest paid to bond purchasers and the interest that can be generated from the unused principal. For this illustration, the difference between the interest paid to bond holders and the interest revenue is one-quarter of one percent. Good management of the unused principal could lower this difference, but federal arbitrage laws do not allow issuing government bond to make a profit. If new proposals and pay plan increases are approved, the bond issue would need to be $226 million. This would be high for gasoline tax revenue bonds at the level of Montana gasoline tax collections. Nearly two-thirds of the annual gasoline tax revenues would be used for debt service payments.

## *OPTION 3: GASOLINE TAX INCREASE*

Option 3 provides estimates of a gasoline tax increase that would maintain the ending working capital balances at $10 million or above for each year from fiscal 2002 through fiscal 2005. The illustration indicates that a one-time, temporary increase of 1.5 cents per gallon only for fiscal 2002 would provide the added revenue to maintain the account above $10 million for present law expenditures.

If new proposals and pay plan increases are approved, the temporary per gallon gasoline tax increase would need to be 2 cents in fiscal 2002, 0.75 cents in fiscal 2003, and 0.5 cents in fiscal years 2004 and 2005.

## *OPTION 4: REMOVE THE DEPARTMENT OF JUSTICE FROM HIGHWAYS SPECIAL REVENUE ACCOUNT FUNDING*

Option 4 provides estimates of the impact on the account if all funding for the Department of Justice is moved to another funding source. If this were the case, the account is projected to have a working capital balance of nearly $89 million at the end of fiscal 2005 for present law expenditures. The balance would decline to $77 million if new proposals and pay plan increases are approved and the Department of Justice is funded from another source. Funding the Department of Justice expenditures, which are currently funded by highways special revenue, from another funding source would reduce expenditures from the account by roughly $19 million per year. A likely funding source for the Department of Justice would be the general fund.

## *OPTION 5: REMOVE THE DEPARTMENT OF JUSTICE NON-HIGHWAY PATROL FUNCTIONS FROM HIGHWAYS SPECIAL REVENUE ACCOUNT FUNDING*

Option 5 provides estimates of the impact on the account if funding for the non-highway patrol portions of the Department of Justice is moved to another funding source. If this were the case, the account is projected to have a working capital balance of nearly $12.3 million at the end of fiscal 2005 for present law expenditures. The balance would decline to negative $2.2 million if new proposals and pay plan increases are approved.

Non-highway patrol functions in the Department of Justice account for roughly $1.5 million of the department highways special revenue expenditures. These functions are in the following programs of the department: 1) Legal Services Division; 2) Motor Vehicle Division Field Operations Bureau; and 3) Centralized Services Division. During the Transportation Funding Study conducted during the 1997-1998 interim, these functions were identified by the department as directly supporting highway traffic safety. All functions of the department that did not directly support highway traffic safety were switched to general fund by the 1999 legislature.

## *OPTION 6: DYED DIESEL ENFORCEMENT*

Option 6 attempts to estimate the impact on the account if revenues increase as the result of increased enforcement of dyed diesel tax evasion. The revenue estimates are, at best, guesses and are net of any increased cost of enforcement. Attempts have been made to more accurately quantify the amount of dyed diesel tax evasion that currently exists. However, no defendable data is currently available.

The department attempted to determine the level of illegal dyed diesel use that is occurring through purchase of fuel at retail outlets. During two random surveillances, between 6 and 11 percent of the non-commercial vehicles purchasing dyed diesel at a retail facility used the fuel in vehicles that traveled on Montana highways. However, the amount of dyed diesel that is sold at retail outlets verses other outlets such as bulk fuel vendors is not known. A 1996 report produced by the Federal Highway Administration estimates that nationwide motor fuel tax evasion of combined federal and state fuel taxes approached $3 billion annually.

The illustration shows the impacts of a 10 percent reduction of fuel tax evasion, beginning in fiscal 2002. For fiscal 2002, the illustration assumes that 17.5 percent of the dyed fuel is sold at retail outlets and a 10 percent reduction of evasion at these retail outlets would occur. This percentage of dyed fuel being sold at retail outlets was selected to illustrate the amount the department stated as a conservative estimate of revenue that could be gained from reducing evasion through enforcement (roughly $3.5 million per year). The illustration assumes a 10 percent annual decrease in the amount of revenue gained from enforcement efforts. The annual reduction of revenue increases was done to illustrate that as enforcement becomes effective and those currently engaged in the practice become aware of the consequences the amount of evasion should decrease. Therefore, the annual revenue increase from this effort should also decrease.

The illustration shows that the fiscal 2005 working capital balance would be $30 million at the end of fiscal 2005 if the level of evasion could be reduced by the amount shown in the illustration (roughly $3.6 million in fiscal 2002, declining to $2.8 million in fiscal 2005). If new proposals and pay plan increases are approved, the fiscal 2005 ending working capital balance would be roughly $15.7 million.

## *OPTION 7: DEPARTMENT OF TRANSPORTATION BUDGET REDUCTIONS*

Option 7 illustrates a proposal by the department that would reduce their request for capital projects by $500,000 per year and reduce preventive maintenance on pavement and rest area maintenance by $5.6 million per year. With the department's proposal and present law expenditures, the account would have an estimated working balance of nearly $26 million at the end of fiscal 2005. If new proposals and pay plan increases are approved, the account working capital balance would be roughly $12.3 million at the end of fiscal 2005.

# CONCLUSION

The working capital balance of the highways special revenue account is projected to go negative in fiscal 2002. Seven options were illustrated to provide relief for the account. The options provide relief for the account in the short-term, but do not address the underlying problem of expenditure growth that is higher than revenue growth, nor do they address the resulting account structural imbalance.

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