DOT - OMB 1995 Budget Review

DATE: December 8, 1993
TO: Carol Rasco
FROM: Mike Schmidt
RE: Today's Department of Transportation Budget Hearing

I thought that it may be useful for you to have a brief summary of some of the issues that may be discussed at today's OMB FY95 Budget Hearing for the Department of Transportation. I have attached, for your information, a more in-depth analysis that was done by Michael Deich for Bob Rubin. This memo will concentrate on one broad issue (that the OMB mark-up indicates a formal choice between two Clinton Initiatives) and two specific issues (full funding of the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA) and proposed cuts in mass transit operating subsidies for small communities).

**Symbolism: A Choice Between Infrastructure and Human Resources Initiatives**

It is important to recognize that, in the "big picture", the across-the-board cuts in DOT's FY95 budget that OMB is proposing will likely be perceived as a public choice by the Administration to increase funding for "people programs" (education and training, Welfare Reform, Head Start, etc.) at the expense of infrastructure spending. I am not in any way trying to argue that this is the wrong choice -- rather, I simply want to point this fact out, keeping in mind that campaign promises were also made to increase infrastructure spending (including full-funding of ISTEA, discussed below). The President should understand this broad point (and probably does already) when making a final decision on the DOT FY95 budget.

**Full Funding of ISTEA**

One of the arguments that may be made at this meeting (by DOT) will be to put back the $2 billion proposed cut from the Highways (ISTEA) budget, thus fully funding ISTEA as promised in the campaign. DOT needs to tell us where to make up the $2 billion restoration to ISTEA -- so far, no suggestions have been offered.

Another argument that might be advanced is that full funding of ISTEA will help solve traffic congestion problems. This is simply not the case. In practical terms, an extra $2 billion in highway (ISTEA) spending will not solve any congestion problems. In fact, DOT estimates that in 1991, it would have taken about $50 billion per year to solve congestion problems on federal-aid highways. In that same year, Federal, State and local spending on federal-aid highways was approximately $32 billion. Since there is no way we are ever going to increase highway spending by $18 billion dollars, the argument seems to be moot. Another fact: statistics show that during the 1980s we spent considerably less that $18 billion annually on highways, yet pavement conditions (not congestion) improved slowly over that same period. So our spending is doing some good.

**Possible Compromise on this Issue:** One interesting question that may want to be raised -- Is there any way that we can split the difference? That is to say, can we increase ISTEA spending by enough so we can say we are doing more than President Bush did, while at the same time scale back the large FY94 spending increase and not fully fund ISTEA? An interesting question.

## Elimination of Transit Operating Subsidies

The current OMB proposal would eliminate all transit operating subsidies. This would effect small, poor, rural communities disproportionately, as they typically depend heavily on transit operating subsidies (federal aid comprises 22% of the transit operating budgets in small communities, but only 5% of budgets nationwide). At the same time, OMB proposes to increase capital spending on transit programs.

**Possible Compromise:** Is there any way to modify transit capital spending increases and retarget those savings to provide transit operating subsidies for small communities?

THE WHITE HOUSE

WASHINGTON

December 7, 1993

MEMORANDUM FOR BOB RUBIN
GENE SPERLING
BO CUTTER

FROM: Michael Deich

SUBJECT: FY 95 Budget for DOT

The OMB mark would reduce DOT's **overall** budget resources by 8 percent -- from $34.9 billion in 94 to $31.9 billion in 95.

- **The big issue: transportation and long-run economic growth**. One approach to this budget would concentrate federal investments on infrastructure, human resources or R&D; another approach would continue to keep a diversified federal portfolio. Which would maximize long-run economic growth?
  - When taken as a whole, federal transportation spending increases private sector productivity to about the same degree as federal spending for human resources and R&D.
  - *There is little statistical evidence to suggest that the economy could be made better off by using across-the-board cuts in transportation to finance across-the-board increases in federal spending for human resources or R&D.*
  - The relationship between economic growth and aggregate public investment in each area is weak. At the same time, specific programs in each area have economic rates of return that exceed the average return to private capital.
  - As a rule, the highest economic benefits in transportation would result from maintaining existing assets and expanding capacity in selected, highly-congested facilities.

- **Infrastructure for the 21st century**: IVHS (intelligent vehicle highway systems) and information infrastructure, not high-speed rail and maglev, are likely to be the next generation infrastructure that grows the economy.

**Highways**. Under the PAD mark, funding would fall from $20.2 in 1994 to $18.0 in 1995. This reduction of $2.2 billion, or 11 percent, would bring funding down to the levels of 1992/1993. This lower level would be sufficient to hold pavement conditions steady (or possibly improve), but congestion would continue to worsen just as it has throughout the last decade. DOT agrees that, in the long run, we cannot build our way out of the congestion problem. *Congestion will be significantly reduced only when local governments adopt congestion-pricing for roads.*

- The PAD mark assumes that Congress rescinds all highway demostration projects. These projects are a low priority for states, and often are uneconomic, but they can be a high priority for Congress and Mayors. If demos are rescinded (something that has never happened on a large scale), then:

| | '93 | '94 | OMB '95 | DOT '95 |
|---|---|---|---|---|
| Primary program ("good" highway $): | 17.3 | 19.1 | 17.8 | 19.9 |
| Demonstration Projects ("bad" highway $): | 0.9 | 1.1 | 0.2 | 0.3 |

  **If Congress does not rescind highway demonstration projects**, the primary program will have to be cut a further $2 billion, and **the Clinton budget for primary highway spending will then be $1.5 billion, or 8 percent, less than the last Bush budget**.

- Pavement Conditions/Maintenance: spending at the OMB mark will be sufficient to continue the trend observed since 1982 of maintaining or improving pavement conditions.

- Congestion has worsened steadily during the last decade, despite a substantial rise in the real resources devoted to roads. The PAD mark contains important nonbudgetary initiatives to tackle congestion (such as congestion pricing).

- **Opposition**:

  - Opponents will cite, a little misleadingly, DOT studies showing that the PAD mark will be inadequate to "maintain conditions," which means no deterioration in either pavement quality or congestion.

  - Opponents will note that this budget calls for the trust fund balances to grow steadily after '95, and will call for "restoring trust to the trust fund."

**Mass transit**. Following the large increases of '92 and '93, the OMB mark would reduce total transit spending: while capital grants would be increased, **operating subsidies would be eliminated**.

- Operating subsidies would be eliminated. Since they began in the mid–70s, operating subsidies have been criticized for increasing the wages of bus operators without significantly increasing service for riders. As operating subsidies have fallen steadily since the mid–80s, costs per mile have levelled off.

  - **By throwing out the baby with the bath water, the PAD mark creates two problems**:

    * small communities depend heavily on operating subsidies (federal aid comprises 22 percent of the operating budgets in small communities, but only 5 percent of operating budgets nationwide). Smaller, poorer communities will be especially hard hit.

* all communities rely on operating subsidies for maintenance; ending the subsidies for maintenance while continuing capital subsidies will encourage communities to overcapitalize their transit fleets.

- A COMPROMISE:

  * limit operating subsidies to small communities.
  * allow capital grants to pay for some asset maintenance (but not operating expenses).

• Capital spending would be increased. OMB would increase capital grants by nearly 25 percent, from $1.6 billion to $2.2 billion. This increase, which follows 40 percent increase in capital grants between '93 and '94, would be used to improve the condition of transit fleets and to provide incentives for local communities to institute congestion pricing on roads.

  - Bus fleets: Since the mid-1980s, a constant 20 percent of the Nation's bus fleet has been classified by DOT as "overage". DOT cannot show, however, that it would be economic to replace these older buses at an earlier age. Since bus conditions have improved slightly over the last decade even with much lower transit budgets, the OMB mark should lead to significant improvements in fleet conditions.

  - Rail needs: Even with lower budgets over the last decade, rail systems have improved since early 1980s. The OMB budget will allow this improvement to continue.

**High-Speed Rail (HSR) and Maglev**. The OMB mark eliminates all spending for HSR-Maglev save $15 million to develop a new high-speed deisel locomotive (which will be helpful to NY and SC). Eliminating the Administration's 5-year, $1 billion program reflects (1) the far greater economic returns that can be achieved elsewhere in transportation, and (2) the huge upfront costs ($10-$25 billion) that would be necessary to achieve true high-speed service (150+ mph).

• Competition from other travel modes limits the benefits of HSR; far higher economic and environmental benefits can be found elsewhere in the transportation budget:

  - While both highways and aviation are supported by user fees, federal HSR would **permanently** require subsidies in the range of $30-$300 per passenger per trip.
  - HSR is designed to be competitive for travel of 200-500 km. Benefit-cost studies show, however, that neither HSR nor maglev would be economic outside the Northeast Corridor. Everywhere else, the greater flexibility and lower cost of road and airline travel prevent rail from attracting significant numbers of riders on intercity routes.
  - During the campaign, the President envisioned $10 billion for a true HSR system. The HSR proposal included in the 94 Budget, however, would make only incremental changes to a handful of existing rail corridors. These marginal changes would have far smaller economic or environmental benefits than hoped for.

- Why does HSR work in Japan, EC but not here?
  - rail is economic only with high population densities. US population densities match those found in Japan and EC only in the NY-Washington and LA-San Diego corridors. Elsewhere in the US, population densities are less than a tenth that found in the EC and Japan.
  - HSR in France and Japan actually makes money. In the US, the more developed road and aviation networks make cars and airlines a cheaper, more flexible alternative than HSR.

- **Opposition**. Although there is no entrenched constituency to object, this PAD mark would require a campaign promise to be abandoned on the grounds that it cannot be afforded given new budget constraints.

**Aviation**. The OMB mark would reduce the airport improvement grants by about 25 percent. The largest airports would no longer be allowed to receive grants, and would instead receive low-interest loans with subsidy rates of 25 percent.

- This proposal is readily defensible. Large airports need little help to finance capital improvements. These airports have access both to capital markets and to the receipts from user fees (including the federally-approved passenger facility charges).

- A political caution -- in 1990 aviation ticket taxes were raised on the condition that the money would go to AIP grants. Under this budget, the aviation trust fund balances would grow substantially, leaving the Administration open to the charge that it was "reducing the deficit with aviation taxes."

**Rail**. The OMB mark would leave Amtrak's budget for both capital and O&M largely unchanged. This holding pattern will allow the new Amtrak Chair and the Federal Rail Administration to complete their long-term planning needed for next year's reauthorization bill.

**National Infrastructure Bank**. OMB is trying to develop an on-budget loan program under the title of a "National Infrastructure Bank". A lot of work needs to be done before bringing this up for the President's consideration.