

## The Transportation Funding Loophole

### How States Underfund Federal Programs

A financial loophole in the federal transportation funding system allows states to put money into the federal highway programs they prefer, while neglecting other federal programs. States do not need to officially register these "transfers," nor do they currently report on them.

#### How States Control Federal Transportation Dollars

State Departments of Transportation decide how the majority of federal transportation dollars are spent. The funding process for highways can be described in three steps: 1) Congress gives states contract authority levels, also known as apportionment, for each program; 2) Congress gives states an obligation limit, which is not differentiated by program; and 3) states decide where to spend this year's obligation limit – in which programs (e.g., Interstate Maintenance, Surface Transportation Program), and on which projects. States must have contract authority in order to spend the obligation limit.

One way to understand this is to think of the contract authority levels as a set of empty glasses of different sizes, one for each program. The size of the glass indicates the

amount that could be spent in the program. The obligation limit (authority to spend federal funds for projects) is a pitcher with iced tea in it, but it never contains enough to completely fill all the glasses. States decide how much to fill each one. Diagram 1 illustrates the three steps.

The contract authority level (the size of the empty glasses) is set in the six-year transportation bill, most recently TEA-21. Contract authority is differentiated by federal program, for example, the Surface Transportation Program (STP) or the Congestion Mitigation and Air Quality Improvement program (CMAQ). It was originally meant to help states plan for future transportation investments, while the obligation level – the iced tea in the pitcher – was adjusted annually. Now, economy-related adjustments are made through a process called Revenue Aligned Budget Authority (RABA), not through the obligation limit.

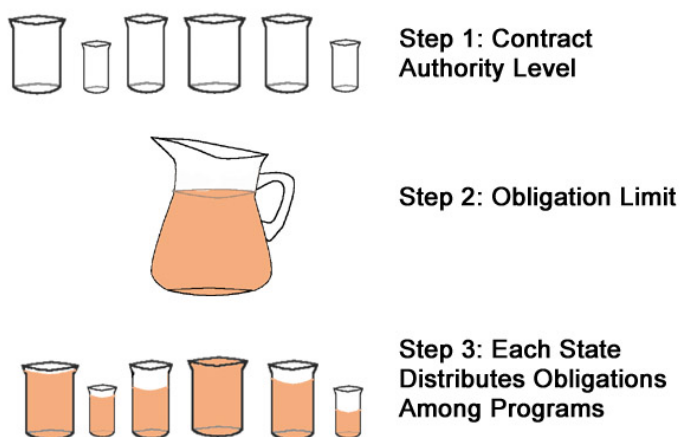
The obligation limit is not differentiated by program. The same obligation limit can be used on any of the TEA-21 core programs, as long as contract authority (empty glass space) exists. Some special program categories, such as high priority projects, are not affected by the general obligation limit.

#### Distributing the Shortfall: The Loophole in the Federal Transportation Program

Since the obligation limit no longer fulfills its original purpose, which was to adjust for economic change, it has fulfilled a different function. In effect, it gives states the option of not investing in certain federal transportation programs. This is due to the "loophole" created by the difference between contract authority and the obligation limit.

Originally, the two funding levels were roughly the same, with periodic fluctuations for budget reasons. From 1992 to 1997, the obligation limit – the amount of iced tea – was 7 percent less than the contract authority on average. Since the TEA-21 bill of 1998, the difference has grown to about 12 percent, meaning that obligation limits only fill up about 88 percent of the contract authority "glasses." States are

Diagram 1: How States Control Federal Dollars



not able to actually spend the 12 percent shortfall.

Each year, this 12 percent shortfall is distributed among the federal transportation programs by the states. Although some distribute the shortfall evenly, many group the shortfall unevenly in a few programs. For example, Illinois' 12 percent shortfall amounted to \$102 million in fiscal year 2001. The Illinois Bridge program could hold \$138 million in 2001, but the state put only \$61 million into this program. This left the Bridge "glass" less than half full. This program alone absorbed over half of the state's shortfall for the year. In contrast, the Interstate Maintenance program was "overfilled," funded at 102% of the 2001 contract authority level.

This last statistic raises an important question, though: how does a state spend more than the year's contract authority level on one program? And what happens to the unspent contract authority in Illinois' Bridge program?

### The Nature of the Loophole

The graph at right shows the ratio of contract authority to obligations, the "obligation rate," across the U.S. during the first four years of TEA-21. Most programs are well below 88 percent, which would be each program's fair share of the obligation limitation.

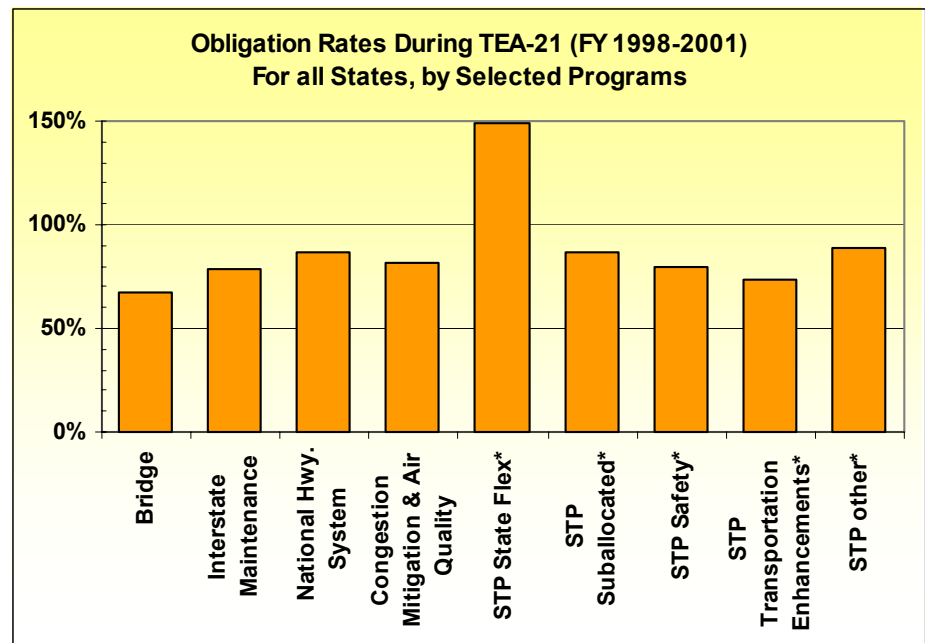
Official transfers account for one portion of the 'overspending.' As shown in the graph, the STP State Flex program was overspent by almost 50 percent during the first four years of TEA-21. STP State Flex is the most common recipient of transfers between programs.

However, 'overspending' a program, as Illinois did in 2001, is mostly explained by *accumulated* contract authority. The

shortfall in contract authority that is distributed among the programs, which appears as empty glass space in the graphic above, actually accumulates over time. This "empty space" is known as the *unobligated balance*. States are free to use both the unobligated balance and new contract authority each year.

The loophole provided by unobligated balance is growing over time. The unobligated balance for the entire federal program was \$26.4 billion at the end of fiscal year 2001, almost as much as the entire new contract authority distributed each year. The law requires contract authority to expire after four years, but the U.S. Department of Transportation has not put this process into effect.

The convoluted accounting behind the situation has created confusion among the public and decision-makers, who are seeking greater predictability about program funding from year to year. Moreover, this disparity has undermined key federal priorities set forth in the 1991 ISTEA law, including funding commitments to improve safety and air quality and to enhance communities.



\*Surface Transportation Program (STP) has been broken down into subcategories.

#### Sources

The data on obligations are available from the FHWA report M79A. Transfers to FTA from FHWA programs were made available by the FHWA. Contract authority amounts are from Federal Notices.

For further information, see:

<http://www.transact.org>

<http://www.tea3.org>