TESTIMONY OF

JACK SCHENENDORF, OF COUNSEL
COVINGTON & BURLING

ON BEHALF OF ASSOCIATED GENERAL CONTRACTORS OF AMERICA

BEFORE THE SUBCOMMITTEE ON WATER RESOURCES AND ENVIRONMENT
COMMITTEE ON TRANSPORTATION AND INFRASTUCTURE
U.S. HOUSE OF REPRESENTATIVES

ON

FINANCING WATER INFRASTRUCTURE PROJECTS

JUNE 8, 2005

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Mr. Chairman and Members of the Subcommittee:

My name is Jack Schenendorf. I am Of Counsel to the law firm of Covington & Burling in Washington D.C. My practice focuses primarily on transportation and legislative matters, including parliamentary procedure and the federal budget. I also had the honor of serving on the staff of this Committee from 1976 to 2001, including serving as Chief of Staff from 1995 to 2001.

I am pleased to respond to the Subcommittee's invitation to appear and testify on behalf of the Associated General Contractors of America on the financing of water infrastructure projects.

My Washington career started in 1975 as a staff member on the National Commission on Water Quality. The Commission, chaired by Vice-President Nelson Rockefeller, was established to determine whether Congress should

make mid-course corrections to the landmark Federal Water Pollution Control Act of 1972. As part of its charge, it issued a report.

Among its findings, the Commission's report identified an "inadequate rate of federal funding" as one of the primary reasons why publicly owned treatment works would not meet the Act's requirements in a timely way. And this was at a time when the Federal Government's share of the program was 75 percent and authorized funding was as high as $7 billion per year.

Not only has the situation not improved over the past 30 years, if anything, it has gotten worse. Today, the federal share has dropped significantly and federal funding has plummeted to less than a billion dollars per year. Not surprisingly, the Congressional Budget Office and the General Accountability Office have independently confirmed a water infrastructure funding gap of between $300 billion and $500 billion over the next 20 years.

Which brings us to the subject of today's hearing--how to finance this enormous water infrastructure funding gap.

Last Congress, this Subcommittee and the Senate Environment and Public Works Committee each sought to address part of this funding shortfall by authorizing a total of approximately $20 billion in general fund financing over a five-year period for wastewater treatment projects. By itself, this legislation--if it had been enacted into law--would not have provided a penny of funding. Appropriations would have been required, a tall order in the current budget climate. If the authorized funding was to materialize, either the deficit would have to be increased by $20 billion, or if deficit-neutral, other discretionary programs would have to be cut by $20 billion. Moreover, the funding would be subject to the uncertainty and vagaries of the annual appropriations process, making state and local governments reluctant to commit to long-term infrastructure funding projects.

There is, in my judgment, a better approach. I encourage the Subcommittee to consider financing water infrastructure projects in the same way that transportation infrastructure projects are financed--that is, through self-financed, deficit-proof trust funds.

Like the transportation trust funds, a water infrastructure trust fund would possess several attributes:

- A system of user taxes would be established;
- The revenues generated by these user taxes would be credited to the trust fund, ensuring that the revenues are spent for their intended purpose;
- Budget authority (e.g. contract authority) provided from the trust fund would not be subject to the annual appropriations process; and
- The trust fund would either be outside the unified budget or subject to a guaranteed funding mechanism to ensure a linkage between revenues and spending.

The guaranteed funding mechanism deserves further discussion. It was included in the Transportation Equity Act for the 21st Century (TEA 21) to end the practice of borrowing from the trust fund to mask the deficit or finance other general fund programs. This practice--which had been going on from the time the trust fund was incorporated into the unified budget--was a fraud and a sham. TEA 21 established budgetary firewalls and a point-of-order to end this shameful practice. It has worked well and should be included in infrastructure trust fund financing mechanisms that are part of the unified budget.

Financing water infrastructure through a trust fund would have several advantages over general fund financing. First, it would be deficit neutral. It would pay for itself. Second, the funding stream would not be subject to the vagaries of the annual appropriations process, thereby providing the certainty that State and local officials need to commit to long-term infrastructure financing. And third, it would get the job done provided revenues were sufficient to meet the need.

The biggest challenge to implementing this approach is establishing the system of user taxes to generate the revenue stream. Who should pay and how much should they pay? These issues will be controversial and, at times, may seem insurmountable.

But one can look at the origin of the Highway Trust Fund to see that seemingly insurmountable problems can be overcome.

Prior to 1956, the federal highway program was funded from general revenues. There was a federal gas tax but its proceeds were not earmarked. A federal excise tax of 1 cent per gallon was first put in place in 1932 as a

temporary emergency depression measure and was increased to 1.5 cents in 1941 and 2 cents in 1951.

Once it became clear that this temporary tax was not going to be repealed, it was opposed by many groups, including the Association of State Highway Officials (AASHO), the automobile manufacturers, the trucking industry, the oil industry and certain farmer organizations. The opposition was strongest in the early 1950's when the Governors' Conference threw its weight behind repeal, arguing that the gas tax should be reserved for the states.

Against this background, Congress was trying to promote what would become the Interstate System. The 1944 Highway Act called for a 40,000 mile National System of Interstate Highways. But because of limited funding, very few of the Interstates were built between 1944 and 1955. In January 1955, the price tag on the Interstate System was estimated at $27 billion over a 13-year period. In 2005 dollars, this would be the equivalent of a $185 billion investment over 13 years.

In took several years and several government studies to come up with a way to finance the $27 billion investment. During this process, three financing

alternatives were explicitly considered and rejected--general fund financing, tolling and bonding.

Finally, proponents of increased investment embraced the strategy of financing the Interstate System by increasing the federal excise taxes levied on highway users. When legislation embodying this approach was first considered on the House Floor in 1955, it was soundly rejected by a bipartisan vote of 123 to 292. One of the major reasons that the bill failed was because of the strong opposition of the various interests and industries that would have paid the increased taxes. Included in the opposition were the rubber industry, motor fuel refiners and sellers, intercity bus companies, the trucking industry, the AAA and the Teamster's Union.

Between 1955 and 1956, there were two major developments. First, supporters of the pay-as-you-go approach, such as the construction industry, mounted an extensive lobbying campaign in 1956 and were far more effective than they had been in 1955. This is where the "highway lobby" earned its reputation. Second, many of the groups that had opposed the 1955 bill changed their minds, even though the tax proposals either did not change or in some cases got even worse. Essentially, many of the critics had a

chance to think their positions through more thoroughly. Some decided that the 1956 bill treated them a little better than the 1955 bill. Others were more willing to accept the idea of increased taxes and to focus instead on a fair distribution of the tax burden. Some became supportive once Congress agreed to include in the bill a study that would look at the fairness of the tax burden. Some groups, however, remained opposed. For example, the petroleum industry's goal remained repeal of the gas tax.

Ultimately, the 1956 Highway Act passed the House and Senate by overwhelming votes even though it raised a variety of highway user taxes, including a 50 percent increase in the gas tax and the tire tax and imposition of a new licensing fee on heavy trucks. A key aspect of the legislation was the creation of the Highway Trust Fund into which all of these revenues would be deposited, to be available for expenditure without further congressional authorization or appropriation. While there were many reasons for this turnaround, most noteworthy was the improved lobbying campaign that won over many of the critics.

The rest is history. The 1956 Highway Act--one of President Eisenhower's most important achievements--has been described as the "best investment a

nation ever made." It often appears on "Top 5" or "Top 10" lists of federal legislation that really mattered. And it is often described as the law that created the Interstate System. But that is not really correct. The Interstate System was really created in the 1944 Highway Act. The 1956 Act created the Highway Trust Fund--the financing mechanism that made the Interstate System a reality. That is the genius of the 1956 Act.

Today the Highway Trust Fund continues to be one of the most successful federal financing mechanisms, providing about $33 billion per year for highway investment. Moreover, the success of the Highway Trust Fund persuaded Congress to create other transportation infrastructure trust funds.

The second transportation trust fund to be established, the Airport and Airways Trust Fund, was established in 1970 to finance capital improvements to the nation's airport and airway system. Today, the Trust Fund raises about $11 billion per year through a variety of user taxes for capital improvements as well as FAA operating expenses.

In 1982, Congress created a third transportation trust fund--the Mass Transit Trust Fund (actually a separate account in the Highway Trust Fund)--to

finance capital spending on new and rehabilitated mass transit infrastructure. Today the transit trust fund raises about $5 billion per year through the gas tax for capital improvements to the nation's public transportation systems.

In addition, Congress created a number of smaller transportation trust funds, including the inland waterways trust fund, the harbor maintenance trust fund and the national recreational trails trust fund.

These transportation trust funds have been enormously successful in creating stable, dependable revenue streams for funding transportation infrastructure projects. But in each case, there was a contentious debate over who should pay and how much should they pay. Congress concluded each time, that the societal and political benefits of the transportation infrastructure investment outweighed the negative consequences of establishing the revenue stream.

Water infrastructure projects deserve no less. As Dr. Luntz has indicated, Federal legislation creating a long-term, sustainable and reliable trust fund for clean and safe water infrastructure has strong support among the American people. If Congress develops a fair and defensible system for raising the revenue, I believe a water infrastructure trust fund is achievable.

The benefits for the American people, business and the environment would be enormous.

Thank you.